UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.	)	
	)	
Central Hudson Gas & Electric Corporation	)	
	)	
Consolidated Edison Company of New York, Inc.	)	**Docket No. RT01-95-000**
	)	
Niagara Mohawk Power Corporation	)	
New York State Electric & Gas Corporation	)	
Orange & Rockland Utilities, Inc.	)	
Rochester Gas & Electric Corporation	)	

REQUEST FOR REHEARING OF THE
NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

Pursuant to Section 313(a) of the Federal Power Act ("FPA"),[1] and Sections 212 and 713 of the Commission's Rules of Practice and Procedure,[2] the New York Independent System Operator, Inc. ("NYISO"), by counsel, hereby respectfully requests rehearing of the Commission's July 12, 2001 *Order on RTO Compliance Filing* in the above-captioned proceeding ("NYISO Order").[3]

I. INTRODUCTION AND SUMMARY OF POSITION

The NYISO is a not-for-profit New York corporation, charged with administering fair and efficient wholesale electricity markets and with maintaining reliability in New York State. The NYISO's successful fulfillment of these responsibilities is central to the economy, health and welfare of New York State. The NYISO does not necessarily object to the formation of a

1 16 U.S.C. 825(a) (1994).

2 18 C.F.R, §§ 385.212 and 713 (2001).

3 *New York Independent System Operator, Inc.*, *et al.,* 96 FERC ¶ 61,059 (2001).

larger super-regional Regional Transmission Organization ("RTO") that encompasses New York and assumes some or all of the NYISO's current functions. Nevertheless, it is determined to ensure that the establishment of such an entity does not endanger the reliability of electric service in New York, or cause the kind of market disruptions, and concomitant consumer hardships, that have occurred elsewhere. Because the NYISO Order does not give appropriate attention to these matters, and because it contains a number of material legal and factual, errors the NYISO must seek rehearing. If the NYISO is satisfied that these concerns are being addressed properly it can always withdraw this request for rehearing, or terminate any subsequent litigation.

The NYISO Order rejected a January 16, 2001 filing ("Joint Filing") submitted by the NYISO and six members of the Transmission Owners Committee of the Energy Association of New York State ("Member Systems")[4] which had proposed that the NYISO be certified as a RTO pursuant to Order No. 2000.[5] Instead, the Commission concluded that there must be "a single, fully-integrated RTO with a single set of market rules and one market design in the Northeast."[6] It therefore mandated that the NYISO, the PJM Interconnection, L.L.C. ("PJM"),[7]

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[4] The six filing Member Systems were Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, Inc., Niagara Mohawk Power Corporation, New York State Electric & Gas Corporation, Orange & Rockland Utilities, Inc. and the Rochester Gas and Electric Corporation. The two remaining Member Systems, *i.e.,* LIPA and the Power Authority of the State of New York supported the filing, but were not applicants because of their non-jurisdictional status.

[5] *Regional Transmission Organizations,* Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. and Regs. ¶ 31,089 at 30,993 (2000); *order on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088 (Mar. 8, 2000), FERC Stats. and Regs. ¶ 31,092 (2000), *review pending sub nom. Pub. Util. Dist. No. 1 of Snohomish County, WA v. FERC*, Nos. 00-1174 *et al.* (D.C. Cir.) (hereafter, "Order No. 2000").

[6] NYISO Order, *slip op.* at 13.

[7] *See PJM Interconnection, L.L.C., et al.*, 96 FERC ¶ 61,061 (2001) ("PJM Order").

and ISO New England, Inc. ("ISO-NE"),[8] collaborate with their stakeholders to create a single RTO, using PJM's market rules and software as a "platform."

The NYISO has always been a strong proponent of electricity competition and has supported the establishment of well-functioning markets in the Northeast and elsewhere. It has consistently been willing to increase the integration of its markets with those of its neighbors,[9] and to consider closer structural integration, including possible combinations with them, provided that such integration is found to be in the public interest. It has no objection to the creation of a super-regional RTO so long as the development process addresses responsibly New York's special reliability needs, and allows for the adoption of NYISO market features that represent the "best practice." If the establishment of a single Northeastern RTO were determined, after an appropriate review, to be the most efficient, reliable and cost-effective outcome, the NYISO will fully support it. At the same time, the NYISO believes that the Commission must be open to reasonable alternatives that may more quickly and less expensively capture the benefits that a single RTO is expected to bring.

The NYISO Order has ignored important reliability, technical and engineering considerations. Failing to consider these factors could result in serious harm to New York. The NYISO is therefore submitting this rehearing request in order to ensure that the RTO formation effort does not lose sight of the needs of New York State's economy, or the well-being of its citizens. It is also acting to preserve its rights with respect to several key legal issues where the Commission has made substantial errors.

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8 *See Bangor Hydro-Electric Company, et al.*, 96 FERC ¶ 61,063 (2001) ("ISO-NE Order").

9 For example, as the Joint Filing and more recent NYISO submissions relate, the NYISO has played a leading role in a number of market integration initiatives, including a joint effort, with ISO-NE and the IMO, to develop a single Northeastern Day-Ahead energy market.

The NYISO Order adopts an overly simplistic view of complex issues and ignores recent policy mistakes, in California and elsewhere, that confirm the need for a more thoughtful approach to RTO issues. A sound RTO formation policy must recognize that the reliable provision of electricity is essential to modern life and to economic growth, must consider that creating efficient markets and RTOs requires careful analysis, substantial time and significant financial and human resources, and must carefully evaluate the costs and benefits of various options. Perhaps most importantly, the development of a sound RTO policy should also benefit from recent history's lesson that ill-conceived market designs can have unfortunate, and occasionally disastrous, consequences.

Such mistakes must not be repeated in the Northeast. A single Northeastern RTO would be both electrically and geographically enormous If the Ontario IMO's market were fully integrated with the three existing ISO markets, the RTO would serve a combined peak load of 133,000 MW, operate (in coordination with the IMO) 46,000 miles of transmission lines and cover a region with a population of 65 million people.[10] Its service area would include the nation's political center, Washington, D.C., its (and the world's) financial center, New York City, and the major metropolitan areas of Philadelphia, Boston and Toronto. It would also include a number of severe transmission constraints and dense, electrically complex sub-regions, such as New York City. A system of this size and complexity has never been attempted before. It is not known whether such a system could be efficiently operated or whether existing ISO software systems would be capable of managing it.

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[10] If the IMO were excluded from consideration, the Northeast RTO would still be unprecedented in size, serving a combined peak load of approximately 108,000 MW, operating 27,000 miles of transmission lines and encompassing a population of 54 million people.

Similarly, a combination of large, separate and fully operational ISOs that already administer sophisticated energy markets has never been attempted. The task clearly will not be easy and could have adverse unanticipated effects. Given the economic and political importance of the Northeast, and in light of the sensitivity and fragility of its transmission system, RTO policy decisions that will affect it must be made deliberately. Rash actions can lead to market power abuses, blackouts and other, potentially dangerous dislocations.

Unfortunately, the NYISO Order has mandated that Northeastern stakeholders move to create a single RTO without any analysis of the challenges, costs, benefits and other implications of the single RTO/single market model.[11] It has declined to evaluate seriously available RTO policy alternatives that could be more efficient. It has also insisted that PJM's market rules and software be the "platform" for a Northeast RTO without assessing whether, or how well, they will work when applied to New York, or the entire Northeast. This is an unduly precipitous approach that should be reconsidered on rehearing.

Furthermore, the NYISO Order is unnecessary and likely to be counterproductive. The three existing ISOs (and the Ontario IMO) had already committed to implementing standardized market rules, common transaction-scheduling procedures and other "seams" solutions. These initiatives would likely have captured nearly all of the potential benefits of moving to a single RTO, without the costs and distractions of a merger. Preempting these efforts, directing stakeholders to discard prior accomplishments and start from scratch, and provoking major legal

[11] The Commission has initiated a mediation process that may allow for consideration of the costs and benefits of different structural and operational options within the framework of a single RTO that operates a single market. The Commission has refused, however, to rationally assess the costs and benefits of moving to a single RTO and a single market and has simply presumed that this is the best outcome.

challenges is more likely to retard RTO development than it is to accelerate it.[12] The Commission should chart a more reasonable, and fruitful course.

Moreover, even if the Commission's policy decisions were not open to question, its conclusions would still be legally dubious. The Commission concluded that the NYISO did not qualify as an RTO primarily because it believed that the NYISO: (i) lacked sufficient size and scope; (ii) had not, and could not, achieve the "effective" scope necessary to become an RTO by establishing "cooperative agreements" with its neighbors; and (iii) was insufficiently independent from its market participants. The Commission also noted several other perceived deficiencies in the NYISO's RTO proposal, most of which basically pertain to its size, scope and independence.

The NYISO respectfully submits that these holdings are unlawful, arbitrary and capricious and urges that they be overturned on rehearing. As is set forth in detail below, the NYISO Order's major legal flaws include its: (i) abrupt and unexplained departure from fundamental principles established by Order No. 2000; (ii) inconsistency with recent Commission precedent; (iii) violation of basic administrative law rules governing the promulgation and amendment of substantive rules; (iv) arbitrary and capricious failure to engage in reasoned decisionmaking; and (v) failure to offer the NYISO and the Member Systems an opportunity to modify their RTO proposal to address the Commission's concerns. The Commission must reverse the unlawful, arbitrary, capricious and erroneous aspects of the NYISO Order.

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[12] In particular, by focusing exclusively on its preferred one RTO, one market end-state and by failing to acknowledge that it will take time to achieve, the Commission has created irrational opposition to short-term market improvements that would greatly enhance market efficiency and would be consistent with moving to a single RTO, if that is ultimately found to be desirable.

Consequently, for reasons of both law and policy, the NYISO respectfully asks that the Commission grant its request for rehearing and reverse its: (i) decision regarding scope and configuration, (ii) determination that the Northeast is a "natural market;" (iii) mandate that there be a single "Northeast RTO;" (iv) requirement that PJM's market rules and software be the "platform" for the Northeast RTO; (v) conclusion that the NYISO lacks sufficient independence; (vi) findings that the NYISO's operational authority, tariff filing rights, congestion management practices, parallel path flow procedures and inter-regional coordination efforts fall short of its RTO standards. The Commission should also clarify that even if the NYISO's proposal was deficient with respect to inter-regional parallel path flow management and transmission planning the NYISO can still qualify as an RTO because it is not required to fully resolve these issues until 2004. In addition, the Commission should either declare the NYISO to be an RTO or permit it to make a compliance filing to correct any deficiencies in the Joint Filing. Finally, if the Commission continues to believe that it must mandate the formation of a single RTO and prescribe its boundaries, it should, at a minimum, initiate a rulemaking proceeding so that it may more thoroughly evaluate the technical details, costs, benefits and implications of various RTO formation options. Such a proceeding would permit the Commission to fulfill its responsibilities and enable it to make more rational policy decisions.

II. REQUEST FOR TIMELY COMMISSION ACTION

The Commission recently announced that it had made timely action on all rehearing requests an important priority and that it would strive "to ensure that all rehearings of Commission orders, absent truly extraordinary circumstances, are resolved within 30 days of

filing, thereby promoting certainty and allowing for appropriate judicial review."[13] The NYISO urges that the Commission follow this policy and act on this rehearing request expeditiously.

The NYISO is currently participating in a RTO mediation process that is heavily influenced by the unlawful and arbitrary aspects of the NYISO Order. Absent timely Commission action, the NYISO, and other participants cannot be certain whether the mediation process will continue on its present path or be substantially redirected. This uncertainty could make the mediation process less fruitful and delay work on needed short-term market improvements that are consistent with the establishment of a single RTO. The NYISO is also concerned that the mediation process may produce an irrational RTO formation plan if certain aspects of the NYISO Order are not modified.

Moreover, in the event that the Commission decides to reject this request for rehearing, it should not raise the stakes of judicial review by delaying final action. Because the legal issues are so important, because the NYISO Order is already affecting the NYISO's structure, markets and personnel and because it will have an even greater effect in the near future, justice delayed would be justice denied. Since there are no "truly extraordinary circumstances" that would warrant a delay, or justifiably override the NYISO's due process rights, the Commission should act on this request within the 30-day statutory period.

III. THE NYISO'S DECISION TO SEEK REHEARING IS NOT INCONSISTENT WITH THE MEDIATION PROCESS CURRENTLY UNDERWAY IN DOCKET NO. RT01-99-000 OR WITH VOLUNTARY EFFORTS TO ESTABLISH RTOS

Concurrent with the filing of this request for rehearing, the NYISO is submitting a limited request for rehearing of the Commission's July 12, 2001 *Order Initiating Mediation*

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[13] *Major Accomplishments of the First 100 Days at the Federal Energy Regulatory Commission, January 22, 2001 to the Present* (May 15, 2001) <http://www.ferc.gov/news/pressreleases/major100.pdf>.

("Mediation Order") in Docket No. RT01-99-000.[14] The limited request focuses on the Mediation Order's conclusion that "it is necessary that the three independent system operators in the Northeastern United States combine to form one Regional Transmission Organization," and its statement that the sole purpose of the mediation process is "facilitating the formation of a single RTO for the Northeastern United States."[15] These rehearing requests are not attempts to undermine the mediation currently being conducted by Administrative Law Judge H. Peter Young in Docket No. RT01-99-000, or to impede voluntary RTO formation in any region. The NYISO has been, and will continue to be, an active participant in the mediation. If the mediation produces a rational RTO plan that serves the public interest, and is approved by the Commission, the NYISO will fully support it. The NYISO is also willing to participate in post-mediation collaborative discussions, with Judge Young as mediator. In the interim, however, the NYISO is submitting its requests in a good faith attempt to persuade the Commission to reverse mistaken decisions, and to preserve its legal rights.

IV. SPECIFICATION OF ERROR

In compliance with Rule 713(c)(1), the NYISO respectfully submits that the NYISO Order was erroneously decided because:

- It ignores critical facts, makes unsubstantiated assumption and arrives at a decision that is poor public policy, inconsistent with the public interest and potentially harmful to the economy and welfare of New York State.

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14 *Regional Transmission Organizations*, 96 FERC ¶ 61,065 (2001).

15 Mediation Order, *slip op.* at 1.

- It makes a radical, unexplained break from basic policy principles established by Order No. 2000, and effectively reverses several of Order No. 2000's most important holdings, by declaring that "the Northeast" is a "natural market" which must have a single RTO.
- It fails to properly apply Order No. 2000's boundary evaluation and regional configuration factors and ignores Order No. 2000's conclusions that there is no single "right" set of RTO boundaries.
- It violates the Administrative Procedure Act by attempting to establish new substantive rules, and amend existing ones, without engaging in a notice and comment rulemaking.
- It attempts to apply these improperly promulgated rules retroactively.
- It circumvents its obligations under the National Environmental Policy Act of 1969, the Regulatory Flexibility Act and OMB regulations that pertain to agency rulemakings.
- It determined that "the Northeast" was a "natural market" in an arbitrary and capricious manner and without engaging in a reasoned decisionmaking process.
- It failed to consider the costs, benefits and reliability implications of forcing the formation of a single RTO.
- It failed to consider its own precedent, its own market definition standards, the physical reality of the Northeast's transmission system and trading patterns, and the reality of parallel path flows when it defined "the Northeast" as a natural market.
- It failed to provide a reasoned explanation of the criteria it used to define "natural markets."
- It failed to engage in a reasoned decisionmaking process and did not consider reasonable alternatives, or its own precedent, when it concluded that there could only be a single RTO in the Northeast.

- It unlawfully attempts to mandate the formation of an RTO, in violation of Order No. 2000 and in violation of limits on its authority pursuant to Section 202, 203, 205, and 206 of the Federal Power Act.
- It unlawfully, arbitrarily and capriciously concludes that the PJM market design and software are an appropriate "platform" for the Northeast.
- It contravened Order No. 2000, and its own precedent, by failing to allow the NYISO to submit a compliance filing.
- It arbitrarily and capriciously concluded that the NYISO lacked sufficient independence to be an RTO.
- It misapplied the requirements of Order No. 2000, and failed to engage in a reasoned decisionmaking process, when it concluded that the NYISO's operational authority, tariff filing authority, congestion management practices, parallel path flow procedures, transmission expansion authority and inter-regional coordination efforts fell short of Order No. 2000's standards.
- It arbitrarily and capriciously concluded that the NYISO did not qualify as an RTO.

V. ARGUMENT

A. THE COMMISSION'S CONCLUSIONS REGARDING THE NYISO'S SCOPE AND CONFIGURATION ARE INCONSISTENT WITH ORDER NO. 2000, UNLAWFUL, ARBITRARY AND CAPRICIOUS

1. The Commission's Conclusion that the Northeast Constitutes a "Natural Market" That Must Have a Single RTO Is Inconsistent with Order No. 2000

In Order No. 2000, the Commission required that all RTOs posses appropriate regional size and configuration, but made no attempt to prescribe specific RTO boundaries. Indeed, the Commission went so far as to deny requests that it establish "rebuttable presumptions that

particular boundaries are appropriate starting points."[16] The Commission acknowledged that RTO formation posed difficult technical questions and accepted that because "transmission owners, market participants and regulators" have "a better understanding of the dynamics of the transmission system" in their region, they were better able to propose a "workable solution."[17] The Commission concluded that "there is likely no one 'right' configuration of regions," that "[o]ne particular boundary may satisfy one desirable RTO objective and conflict with another," and that flexibility was imperative because appropriate regional configurations were likely to evolve.[18] Accordingly, the Commission stated that the "public interest will best be served if we provide guidance in this Final Rule, in the form of factors that affect appropriate regional configuration, without actually prescribing boundaries."[19]

As part of its effort to provide guidance, Order No. 2000 identified six "regional configuration factors" and nine "boundary evaluation factors" that would be considered in the analysis of proposed RTO boundaries.[20] Order No. 2000 emphasized that it was not "appropriate to identify one factor as the most important"[21] and that "assessing the appropriateness of a region's configuration will require balancing factors and a flexible approach."[22] It emphasized that the Commission was "mindful" state interests regarding RTO boundaries.[23]

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16 Order No. 2000 at 31,079.

17 *Id.*

18 *Id.* at 31,080.

19 Order No. 2000 at 31,080.

20 *Id.* at 31,082-85.

21 *Id.* at 31,085.

22 *Id.* at 31,083.

23 *Id.* at 31,080.

The Commission's intent to establish a flexible, non-prescriptive RTO boundary policy is embodied in the regulatory text promulgated under Order No. 2000. Section 35.34(j)(2) of the Commission's Rules and Regulations,[24] reads:

> *Scope and regional configuration:* The Regional Transmission Organization must serve an appropriate region. The region must be of sufficient scope and configuration to permit the Regional Transmission Organization to maintain reliability, effectively perform its required functions and support efficient and non-discriminatory power markets.

Notably absent from the text is any suggestion as to specific RTO boundaries or any indication that there are "natural markets" which must be served by a single RTO. Instead, consistent with the voluntary nature of Order No. 2000, the Commission explained that the sole consequence of submitting an RTO proposal that was found to have insufficient size and scope would be a denial of RTO status.[25]

The NYISO Order marks a radical break from Order No. 2000. Its introduction abruptly proclaims that there should be four super-regional RTOs in the United States, one for the "Northeast," one for the "Midwest," one for the "Southeast," one for the "West,"[26] and then mandates that an RTO be formed in the Northeast.[27] After mentioning just one of the nine "boundary evaluation factors," the NYISO Order concludes, without support from meaningful record evidence, that there is a "natural market" in the "Northeast," which is arbitrarily defined

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[24] 18 C.F.R. § 35.34(j)(2) (2001).

[25] Order No. 2000 at 31,080 ("As we review a proposal by a regional transmission entity for its scope and regional configuration, if we determine that the scope is inappropriate, that entity will not be deemed to be an RTO and its participants will not be deemed to be RTO participants.")

[26] NYISO Order, *slip op.* at 2.

[27] The Commission has similarly mandated the formation of a "Southeast" RTO. *See, e.g., Southern Company Services, Inc.*, 96 FERC ¶ 61.064, *slip op.* at 4-5, 6 (2001).

as the region encompassed by the NYISO, PJM and ISO-NE.[28] The Commission then leaps to the conclusion that "narrow configuration" of the existing ISOs is creating "artificial constraints" within the supposed natural market. Accordingly, the NYISO was directed to "work with its neighbors and trading partners to form a single, fully-integrated RTO with a single set of market rules and one market design in the Northeast."[29]

Thus, the NYISO Order ignored Order No. 2000's conclusion that there was no "right" set of RTO boundaries and instead, together with other concurrently issued orders, prescribed the borders of four super-regional RTOs. The Commission ignored the opinion of the very stakeholders that Order No. 2000 said had superior knowledge, including the Northeastern state regulatory agencies[30] (three of which have already sought a stay of the Commission's action),[31] the ISOs, every affected transmission-owner and a majority of Northeastern market participants,[32] that the three ISOs each had sufficient size and scope to be RTOs. Instead of attaching equal weight to all of Order No. 2000's regional and boundary evaluation factors, the NYISO Order focused exclusively on one and thereby excluded from consideration clear

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28 NYISO Order, *slip op.* at 11-12.

29 NYISO Order, *slip op.* at 13.

30 *See New York Independent System Operator, Inc.'s Answer to Certain Motions and Request for Leave to Answer and Answer to Certain Comments and Protests* ("NYISO Answer"), Docket No. RT01-95-000 at 27-28 (March 23, 2001) (Summarizing the views of state regulatory commissions); *See also Comments of Hon. Nancy Brockway, Commissioner New Hampshire Public Utilities Commission of Behalf of the Northeastern Regional ISO Coordination Conference*, Docket No. PL01-5-000 at 4 (June 19, 2001) (Expressing Northeastern regulators' opposition to a forced ISO merger.)

31 *See Motion for Stay of the Maryland Public Service Commission, the District of Columbia Public Service Commission and the Virginia State Corporation Commission*, Docket Nos RT01-2-000 and RT01-99-000 (August 1, 2000).

32 The NYISO and PJM RTO filings were endorsed by the requisite super-majorities of each ISO's relevant stakeholder committee. ISO-NE's RTO filing was endorsed by a majority of its market participants.

evidence that the NYISO already has sufficient size and scope to qualify as an RTO. The Commission also ignored essential factual information, such as the relatively limited physical intertie capacity between the Northeastern ISOs.

In short, the Commission's size and scope holdings are inconsistent with Order No. 2000. It is unlawful for the Commission to disregard decisions made through a rulemaking process and embark, without explanation or a supporting record, on an entirely new policy path.[33] The Commission must, at a minimum, reverse on rehearing those aspects of the NYISO Order that are inconsistent with Order No. 2000. It should either rule that the NYISO qualifies as an RTO or permit it to submit a compliance filing addressing any remaining deficiencies. Alternatively, if the Commission continues to favor a single super-regional RTO with prescribed boundaries, it should, at a minimum, commence a rulemaking.

2. The Commission's Attempt to Establish New Substantive Rules Outside the Framework of a Notice and Comment Rulemaking Proceeding Is Unlawful Under the Administrative Procedure Act

Under the Administrative Procedure Act ("APA"), federal agencies, including the Commission, are only permitted to promulgate new substantive "rules" after engaging in public "notice and comment" rulemaking proceedings pursuant to APA Section 553.[34] This is the procedure that the Commission followed when it promulgated Order No. 2000, which is a substantive rule[35] for APA purposes (even though it is colloquially referred to as an "Order.")[36]

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[33] *See, e.g., Louisiana Pub. Serv. Comm'n v.* FERC, 184 F. 3d 892, 897 (D.C. Cir. 1999); Mine *Reclamation Corp. v. FERC*, 30 F. 3d 1519, 1524 (D.C. Cir. 1994).

[34] 5 U.S.C. § 553 (1994).

[35] An APA "rule" is "the whole or part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy . . . ."

As the Commission recently recognized in another RTO proceeding,[37] it is well-settled that agencies may not modify or add to previously adopted substantive rules without conducting a new rulemaking.[38] The APA requires this safeguard because rulemaking is a quasi-legislative activity that best serves the public interest when it is conducted in an open manner that allows for substantial stakeholder input. Attempts to disguise the promulgation of new rules are highly disfavored.

In direct contravention of the APA, the Commission is using the NYISO Order, and other recent RTO orders, to introduce two new substantive rules. First, it has established a new substantive rule that there are four so-called "natural" electricity markets that span the entire United States with the exception of Texas and Florida. Second, the Commission has established a new substantive rule that each of these "natural markets" must be served by one, and only one, RTO. In so doing, the Commission has determined that the benefits of rapidly forming a single RTO for each natural market will exceed the costs, despite the absence of any supporting record evidence supporting, and the presence of contrary evidence.

It is undeniable that these rules are substantive and quasi-legislative in character. Their true nature is betrayed by the fact that they are articulated, for the first time, in the introductions

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[36] *See* Order No. 2000 at 30,991 (Identifying Order No. 2000's status as a 'Final Rule") *See also, Alabama Power Co. v. FERC*, 160 F. 3d 7 at 11, n. 5 (D.C. Cir. 1998) ("FERC, like other agencies, often engages in the practice of labeling an APA "rule" an "Order" . . . .")

[37] *See Carolina Power & Light Co., et al.*, 95 FERC ¶ 61,282, *slip op.* at 21 (2001) (Reaffirming that the Commission could not make a "finding of fact" inconsistent with or supplemental to Order No. 2000 without conducting a notice and comment rulemaking.)

[38] *See, e.g., Utility Solid Waste Activities Group v.* EPA, 236 F.2d 749, 752-55 (D.C. Cir. 2001); Alaska *Professional Hunters Ass'n, Inc. v. FAA*, 177 F. 3d 1033 ("Once an agency gives its regulation an interpretation, it can only change that interpretation as it would formally modify the regulation itself: through the process of notice and comment rulemaking.") (D.C. Cir. 1999); *quoting*, *Paralyzed Veterans of America v. D.C. Arena*, 117 F. 3d 579, 586 (D.C. Cir. 1997).

to the various July 12 RTO Orders,[39] and then applied to the particular facts of individual cases. They represent additions to and, in some cases, reversals of, Order No. 2000's principles. It cannot fairly be claimed that they are mere "interpretations" of Order No. 2000.

For the Commission to unveil new substantive rules in an *ad hoc* manner when issuing adjudicative orders is unlawful and an inappropriate way to make public policy.[40] The Commission's process also unfairly tramples on the rights of interested parties, such as the NYISO, that would have sought rehearing of Order No. 2000 had it included the rules that the Commission is now attempting to impose retroactively.[41]

Previously, in its November 24, 1998 *Notice of Intent to Consult Under Section 292(a)*, which initiated the rulemaking that ultimately culminated in Order No. 2000, the Commission acknowledged that prescribing RTO boundaries was a substantive, rule-making function that should only be pursued through notice and comment procedures. The Notice stated that:

> If the Commission determines there is a need to establish regional boundaries for RTOs to further the goals of full competition and non-discriminatory access, it will do so as part of a rulemaking or other generic proceeding on RTOs. That proceeding will afford State commissions and others an opportunity to comment on the broader policy issues involved in creating RTOs, as well as specific regional boundaries.

Because Order No. 2000 did not provide stakeholders an opportunity to comment on the specific RTO boundaries that are now being mandated, the Commission must now conduct a

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[39] *See, e.g.,* NYISO Order, *slip op.* at 2-3.

[40] In addition, by engaging in *de facto* rulemaking the Commission is improperly circumventing the requirements of the National Environmental Policy Act of 1969, the Regulatory Flexibility Act and various OMB regulations pertaining to agency impositions of reporting and recordkeeping requirements pursuant to final rules. The NYISO reserves the right to address these issue further in the future.

[41] The NYISO reserves the right to further address the legality of the Commission's attempt to engage in retroactive rulemaking.

rulemaking. Commissioner Breathitt's partial dissent from the NYISO Order has already noted that if the Commission intends to "depart from the basic philosophies embodied in Order No. 2000 then . . . it would be only appropriate to initiate a formal notice-and-comment rulemaking proceeding so that [the Commission] could make a reasoned decision informed by the view of the stakeholders in the process --- state commissions, chief among others."[42] The National Association of Regulatory Utility Commissions ("NARUC") recently took a similar position,[43] and several of its member commissions have already asked the Commission to institute a rulemaking.[44]

Such a rulemaking would permit the Commission to analyze the costs and benefits of forming a single RTO compared to alternative configurations, the electrical topology of the Northeast (including the fact that the three Northeastern ISOs serve 108,000 MW of load yet are interconnected by less than 4,000 MW of intertie capacity), the techniques that should be used to properly define "natural markets," software issues and other factors. Engaging in a rulemaking process is essential if the Commission is to revise its RTO policies in a way that best serves the public interest.

3. The NYISO Order's Conclusion that "The Northeast" Constitutes a "Natural Market" That Must Have a Single RTO Is Arbitrary and Capricious

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[42] NYISO Order, Commissioner Breathitt dissenting in part, *slip op.* at 2.

[43] At its recent summer meeting, NARUC called on the Commission to "conduct an appropriate proceeding, including the collection of evidence and the opportunity for comment and participation by all stakeholders, including the States, on the appropriate size and geographic scope of RTOs based on an analysis that includes consideration of . . . [all relevant factors] . . . so that the FERC can consider such evidence and analysis prior to approving specific RTO boundaries." *See* <www.naruc.org/Resolutions/2000/summer/rto.html>.

[44] *See Request for Rehearing of the Maryland Public Service Commission, the District of Columbia Public Service Commission and the Virginia State Corporation Commission*. Docket Nos. RT01-2-000 and RT01-99-000.

Pursuant to APA Section 706(2)(A), decisions made by administrative agencies are unlawful and must be overturned if they are found to be "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law . . . ."[45] The Commission's decisions must be the product of a "reasoned decisionmaking process."[46] The Commission must demonstrate that it has made a reasoned decision based on substantial evidence in the record and the "path of [its] reasoning must be clear."[47] It must examine relevant data and articulate a reasoned explanation for its actions.[48] It must also consider reasonable alternatives to its policy decisions and provide reasoned explanations for rejecting them.[49] Consistent with its responsibility to engage in reasoned decisionmaking, the Commission has an obligation to engage fully the arguments before it, rather than simply dismissing them.[50] It is inherently arbitrary and capricious for the Commission to depart from its own precedent without offering a reasoned explanation.[51]

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45 5 U.S.C. § 706(2)(A) (1994).

46 *See, e.g., K N Energy, Inc. v. FERC*, 968 F. 2d 1295, 1303 (D.C. Cir. 1992). ("It most emphatically remains the duty of this court to ensure that an agency engage the arguments raised before it -- that it conduct a process of *reasoned* decisionmaking."); *Sithe/Independence Power Part., L.P. v. FERC*, 165 F. 3d 944, 948 (D.C. Cir. 1999).

47 *Sithe Independence Power Part., L.P.* at 948; *quoting Northern States*, at 182; *K N Energy, Inc.* at 1302 ("[W]e will uphold an agency's decision 'if, but only if, we can discern a reasoned path from the facts and considerations before the [agency] to the decision it reached.'"); *quoting Neighborhood TV Co. v. FCC*, 742 F. 2d 629, 639 (D.C. Cir. 1984).

48 *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1499 (D.C. Cir. 1984).

49 *Farmers Union Cent. Exch., Inc.* at 1511.

50 *NorAm Gas Transmission Co. v. FERC*, 148 F. 3d 1158, 1165 (D.C. Cir. 1998)*; quoting K N Energy, Inc.*, at 1303.

51 *See, e.g., Louisiana Pub. Serv. Comm'n v.* FERC, 184 F. 3d 892, 897 ("For the agency to reverse its position in the face of precedent that it has persuasively distinguished is quintessentially arbitrary and capricious.") (D.C. Cir. 1999).

Given this legal framework, the NYISO Order's conclusions regarding the NYISO's scope and configuration are arbitrary and capricious. As an initial matter, the Commission's decisions violate basic principles established by Order No. 2000 without offering any explanation for their deviation. They are, therefore, presumptively arbitrary and capricious. In addition, as is set forth in detail below, the Commission decisions are arbitrary and capricious because the Commission: (i) failed to consider the costs and benefits of creating a single RTO in the "Northeast;" (ii) did not engage in reasoned decisionmaking when it found that the Northeastern United States constituted a "natural market," or explain what a natural market is; (iii) did not engage in reasoned decisionmaking when it found that a single RTO was necessary in the Northeast; and (iv) failed to consider reasonable alternatives that could better accomplish its objectives.

a. The NYISO Order Reaches Conclusions About the Costs and Benefits of Forming a Single RTO Without Even Evaluating Them

In the introduction to the NYISO Order, the Commission acknowledges that there will be "start up" costs in forming a single Northeastern RTO, but concludes that "over the longer term" the creation of such an RTO "will foster market development, will provide increased reliability and will result in lower wholesale electricity prices."[52] The Commission goes on to assert that the savings associated with large RTOs will be delayed if "RTOs are permitted to develop incompatible structures and systems, or if we approve RTOs that do not encompass wholesale market trading patterns."

The Commission offers no evidence to support its conclusions. It has provided no evaluation of what the actual costs and benefits of forming a single RTO in the Northeast might

[52] NYISO Order, *slip op.* at 2

be, and has not demonstrated that the benefits would exceed the costs over any given period of time. Nor has it initiated a rational inquiry into the costs and benefits of alternative RTO formation options, such as the "virtual RTO" concept previously proposed by the NYISO. Instead, it has made a decision based purely on ideology and unsubstantiated economic theory. This is the antithesis of reasoned decisionmaking and is arbitrary and capricious.

Although the NYISO Order does not mention it, Order No. 2000 makes various claims that RTOs will bring benefits, but these claims do not support the NYISO Order's holdings. Order No. 2000 did not evaluate potential costs and benefits of specific RTO configurations or the effects of forcing an ISO merger. Instead, it relied on generic data from the Environmental Impact Statement prepared pursuant to the National Environmental Policy Act in conjunction with Order No. 2000.[53] As has been noted elsewhere,[54] the Commission's analysis of the benefits of RTO formation focused on the benefits of implementing open-access. It did not examine whether forming a "Northeast RTO" will bring benefits beyond those already achieved pursuant to Order No. 888,[55] and the creation of the Northeastern ISOs. While the analysis accounts for benefits that open-access was anticipated to bring, *e.g.,* the creation of spot and risk

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53 *See* Order No. 2000 at 31,025-26; 31,232-37.

54 *See, e.g., Petition for Rehearing of Idaho Consumer-Owned Utilities Association, Idaho Energy Authority, Market Access Coalition, Northwest Requirements Utilities, Public UtilityDistrict No. 1 of Snohomish County, Washington and Western Public Agencies Group* ("Consumer Utilities"), Docket Nos. RT01-35-001 and RT01-15-001 (May 25, 2001).

55 *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 1991-96 FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*,. Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997); *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997); *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in part and remanded in part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F. 3d 667 (D.C. Cir. 2000); *cert. granted in part, New York v. FERC*, 121 S. Ct. 1185 (2001).

management markets, large scale trading regimes and secondary transmission capacity markets, it does not account for the fact that these features already exist in the Northeast. In short, the Commission cannot reasonably rely on this analysis to justify the NYISO Order's conclusions.

Moreover, the NYISO Order completely ignores arguments previously advanced by the NYISO,[56] that forcing the three existing Northeastern ISOs to combine and form a single entity would be extremely difficult and expensive. Although the Commission has referred obliquely to these factors as RTO "start-up" costs, it has made no attempt to quantify them.[57] It has not even tried to evaluate major cost elements, such as the expense of developing new software capable of reliably operating markets spanning the entire Northeast, but has instead assumed that they will be inconsequential.

Similarly, the Commission has ignored the primary constraint on inter-ISO trade, *i.e.,* the limited transmission capacity connecting the three ISOs relative to the amount of load that they serve. The NYISO has a peak load of approximately 32,000 MW and is linked to PJM (which has a peak load of approximately 53,000 MW market) by a mere 2350 MW of export, and 2250 MW of import, capacity, and to New England (which has a 25,000 MW peak load) by 1500 MW of export, and 1200 MW of import, capacity. These interties are nearly fully utilized today. Combining the ISOs will do very little to increase inter-ISO trade, and there will continue to be three distinct markets in the Northeast until substantial new transmission capacity is in place.

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[56] *See, e.g.,* NYISO Answer at 20-24.

[57] In other orders, the Commission has implicitly recognized that these costs are significant and that it is harder to combine operational transmission entities than it is to consolidate proposed RTOs that are not yet in existence. *See, e.g., Southern Company Services, Inc.,* 96 FERC ¶ 61.064, *slip op.* at 5 (2001). Nevertheless, the NYISO Order ignores these considerations.

The Commission's refusal to assess, or even acknowledge, this physical reality is incompatible with reasoned decisionmaking.

Indeed, the Commission has not even studied whether an entity as large as a Northeast-wide RTO could reliably operate a "fully-integrated" Northeastern market. The Commission therefore has no basis for presuming that a single RTO will bring "increased reliability" that helps to offset "start-up" costs. The absence of any record support for this key proposition means that it is also possible that the formation of a single Northeastern RTO would actually jeopardize reliability. Likewise, as others have observed,[58] the Commission has offered no data or analysis to support its bald assertion that forming a single Northeastern RTO will result in "lower wholesale electricity prices" for consumers.

In short, the Commission's failure to make a serious effort to rationally weigh the costs and benefits of creating super-regional RTOs is arbitrary and capricious.

b. The Commission's Decision to Define the Northeastern United States As a "Natural Market" Is Unsupported, Arbitrary and Capricious

The NYISO Order declares that there is a "natural market which spans the Northeast region" based on three facts: (i) that "interregional trading among the three Northeastern ISOs is significant and growing," citing inter-ISO import and export figures for 2000;[59] (ii) that "to a certain extent" the "Northeastern ISOs rely on each other to meet their energy needs; whether to acquire supplies or to sell unused capacity," citing certain import figures into New York[60] and (iii) that there is sometimes a convergence between the three ISOs' market clearing prices, citing

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58 NYISO Order, Commissioner Breathitt dissenting in part, *slip op.* at 2; Consumer Utilities at 17-19 and n. 33 (Incorporating prior comments on the subject by reference.)

59 NYISO Order, *slip op.* at 12, n. 19.

60 *Id.* at 12, n. 20.

data for a one-month period in which ISO-NE's 5 minute energy clearing price was set by external dispatchable contracts 14.6 percent of the time.[61] This "analysis" grossly oversimplifies the complex questions that must be addressed before a "natural" market can accurately be defined.

It is certainly not a self-evident proposition that the "Northeastern United States" constitutes a natural market.[62] As was noted above, the three Northeastern ISOs administer large individual markets that are linked by relatively limited transmission capacity. Although the three ISOs have worked together to coordinate their markets, the fact remains that they have evolved separately over many decades and are generally recognized as separate markets by energy industry participants.[63] Indeed, the Commission itself recently recognized that the three ISOs administered essentially separate markets. In its order establishing a new final rule on merger policy, the Commission noted that:

> To simplify the analysis, customers that have the same supply alternatives, as identified in the competitive analysis screen, can be aggregated into a single destination market. The Commission has accepted this approach in a number of merger filings. For example, in Atlantic City/Delmarva, the Commission found acceptable the treatment of PJM as a single destination market **since customers in PJM trade largely with the same set of suppliers. The same is true of mergers occurring within the New England and New York ISOs . . . .** (Emphasis added).[64]

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[61] *Id.* at 12, n. 21.

[62] It appears that the Commission first divided country into four regional markets (plus Texas) for analytical purposes when it prepared its November 1, 2000 *Staff Report on U.S. Bulk Power Markets*. The *Staff Report* included separate sections addressing the "Northeast," "Midwest," "Southeast," "West" and "ERCOT" regions. The Commission did not articulate a coherent rationale for dividing the country in this manner and, to the best of the NYISO's knowledge, information and belief, has never done so since.

[63] For example, *Megawatt Daily*, a leading trade press publication, reports on PJM, New England and New York as separate markets.

[64] *Revised Filing Requirements Under Part 33 of the Commission's Regulations Final Rule* ("Order No. 642"), FERC Stats. & Regs. ¶ 31,111 at 31,884 (2000); *order on reh'g*, 94 FERC

(continued…)

The Commission cannot simply ignore its past findings or its responsibility to make reasoned decisions. A rational attempt to determine whether the Northeast is, or is moving in the direction of becoming, a "natural market," would presumably utilize clear, well-articulated and systematic analytical criteria. The Commission does not appear to have made such an attempt. Indeed, the evidence the Commission offers falls far short of what its own regulations require private parties to include in merger applications in order to properly define geographic markets.[65] Moreover, the Commission has ignored a variety of considerations that would appear to be extremely relevant to the factors that seem to have influenced its decision.

For example, while the Commission has found that the existence of inter-regional trade among the Northeastern ISOs supports its conclusion that the Northeast is a natural market, it has ignored the fact that there is far more transmission capacity, and more power flowing, between the so-called "Northeast" and "Midwest" regions, than there is within the "Northeast." For example, while PJM (including "PJM West") can export up to 2250 MW to New York, it can export 6500 MW to West Virginia and Ohio and 2500 MW to Virginia.[66] It is therefore unclear why the Commission has deemed PJM to be part of the "Northeast," rather than the "Midwest" when it is much more closely interconnected with the Alliance RTO than it is with New York[67]

¶ 61,289 (2001). *See also Consolidated Edison, Inc. and Northeast Utilities*, 92 FERC ¶ 61,255 (2000), *reh'g denied*, 92 FERC ¶ 61,014 (2000); *Energy East Corp. and CMP Group*, 91 FERC ¶ 61,001 (2000).

65 *See* 18 C.F.R. § 33.3 (2001); *See also* Order No. 642 at 31,884-903.

66 The NYISO staff has prepared a graphic, based on published studies, which depicts the non-simultaneous first contingency total transfer capability among the Northeast ISOs, between Canadian entities and the ISOs and Michigan, and between PJM and the states located to its west and south. The graphic is appended hereto as Attachment I.

67 Even Enron, one of the staunchest advocates of a Northeastern RTO has noted that PJM is effectively a "tollgate in the center of trading paths from the Midwest into New York and New (continued…)

Nor can the decision here be squared with the Commission's conclusion that Florida is not part of a "Southeastern" market because it only has 3600 MW of total physical import capability.[68] ISO-NE has only 3250 MW of total import capability, only 1500 MW of which is from the United States, yet the Commission has concluded that it is part of the "Northeast."[69] Furthermore, the Commission has not addressed whether Ontario, which is roughly as well connected to New York as New York is to New England, and which provides a critical pathway for trade between the Midwest and New York,[70] or portions of the upper Midwest itself, should be treated as part of the Northeast. The fact that Ontario is outside of the Commission's jurisdiction does not alter the reality of wholesale electricity trading patterns.

Similarly, although the NYISO Order attached significance to the fact that the NYISO imported at least 1000 MW most of the time, and at least 2000 MW much of the time during January, 2000, the NYISO Order does not assess the significance of these imports in light of the size of the NYISO-administered markets. Nor did the NYISO Order consider whether these import levels were higher or lower than in other months since the NYISO commenced operations, or whether they were in keeping with historic import levels from the period before the NYISO was launched. The Commission's observation that prices in ISO-NE were sometimes set by external resources over a one-month period is likewise hardly conclusive

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England." *Motion for Leave to File Protest One Day Late and Protest and Motion to Consolidate and for Appointment of a Settlement Judge of Enron Power Marketing, Inc.* ("*Enron*"), Docket Nos. RT01-2-000, RT01-86-000 and RT01-95-000 at 10 (February 23, 2001).

[68] *See GridFlorida LLC, et al.,* 94 FERC ¶ 61,363 at 62,336 (2001).

[69] The NYISO is not asserting that GridFlorida, LLC, PJM or the Alliance RTO should be denied RTO status or forced to merge with other entities. It is simply questioning the Commission's rationale for concluding that "the Northeast" is a natural market that must have a single RTO.

[70] *See, e.g., Enron* at 10, n. 9 (Noting that Ontario, like PJM, is a "tollgate" with great influence over trading paths between the "Midwest" and the "Northeast."

evidence given the lack of context and the Commission's failure to compare the frequency with which ISO-NE prices were set by external resources to the frequency with which this occurred in other regions.

To the extent that the Commission believes that the internalization of parallel path flows is significant to the determination of RTO boundaries, its decision that the Northeast is a single market is illogical.[71] The predominant loop flow in the northern part of the Eastern interconnection circulates around Lake Erie.[72] It affects New York, PJM, Ontario, Michigan and Ohio but does not affect New England.[73] Thus, if the Commission literally intends that RTOs must "internalize" loop flows, it should logically favor an RTO configuration that includes the Upper Midwest, as well as Ontario, in the "Northeast," *i.e.*, it should champion a "Lake Erie Region" RTO. The Commission has not explained why it has not taken this approach.

More generally, even though the Commission has proclaimed that there are four natural markets, it has not provided a reasoned explanation of what their boundaries are. It has conceded that it does not know whether Allegheny Energy belongs in the "Northeast" or the "Midwest"[74]

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71 *See, e.g.,* NYISO Order, *slip op.* at 24 (rebuking the NYISO for failing to submit an RTO proposal that would internalize loop flow "within the Northeast . . . .").

72 A basic description of the Lake Erie circulation is appended to this rehearing request as Attachment II, which is excerpted from Lake Erie Emergency Redispatch ("LEER") training materials posted on the NPCC's website. The complete document is posted at <http://www.npcc.org/LEER.asp?Folder=CurrentYear>.

73 Thus, the NYISO, PJM, the IMO, Allegheny Power, DTE Energy, Consumers Energy and First Energy are all members of the NPCC's LEER working group but no New England entities are. ISO-NE has previously argued that New England is not seriously affected by LEER, or any other inter-regional loop flow. *See Joint Petition for Declaratory Order to Form the New England Regional Transmission Organization*, Docket No. RT01-86-000 at 38-39 (January 16, 2001). The Commission has persistently and unreasonably ignored this fact. *See, e.g.,* ISO-NE Order, *slip op.* at 28-29.

74 *See PJM Interconnection, L.L.C. and Allegheny Power*, *et al.*, 96 FERC ¶ 61,060, *slip op.* at 9, n. 15 (2001).

and, more dramatically, whether the entire Southwest Power Pool ("SPP"), which covers all or part of eight states, includes 50,400 miles of transmission lines and serves 61,300 MW of load, should be part of the "Midwest" or the "Southeast" region.[75] This is emblematic of the lack of analytical rigor that characterizes the Commission's approach to market definition. It is also unduly discriminatory to the extent that it allows Allegheny Energy and the SPP utilities to choose between two RTOs, when Northeastern utilities are not afforded a similar choice.

Based on the foregoing, the Commission's conclusion that the Northeast constitutes a natural market is fundamentally flawed. The Commission should reverse this decision on rehearing and, if it intends to define natural markets, should initiate a notice and comment rulemaking.

c. The Commission's Decision that the There Must Be a Single RTO in the Northeast, and Its Exclusion of Reasonable Alternatives Are Arbitrary and Capricious

The NYISO Order claims that the "vitality" of the "natural market" in the Northeast has been hampered by the "balkanized set of market rules that have developed in the Northeastern ISOs since their inception."[76] It cites a number of alleged differences in the ISOs' market rules, claims that such differences "may" discourage inter-ISO trade, and concludes from this that "the narrow configuration of the existing Northeastern ISOs creates artificial constraints within the broader market that spans the Northeastern region."[77]

The NYISO Order acknowledges that Northeast ISOs, and the Ontario IMO, have entered into a Memorandum of Understanding ("MOU") in order to promote greater inter-ISO

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75 *See Southwest Power Pool, Inc., et al.*, 96 FERC ¶ 61,062, *slip op.* at 10 (Noting that it "may be" that SPP should be in the "Midwest" while Entergy should be in the Southeast.)

76 NYISO Order, *slip op.* at 12.

77 *Id.*

coordination.[78] However, the Commission concludes that the MOU process has "proved disappointing" and "does not go far enough to address seams issues" in the putative Northeastern market. It suggests that this is because the "MOU process, to date, has failed to comprehensively address the fundamental market rule differences that exist in the region" and alleges that the MOU has "resulted in missed deadlines and few significant solutions . . . ."[79] Finally, the NYISO Order claims that the "existing MOU process" is insufficient to be considered a sufficiently strong cooperative agreement with neighboring RTOs to establish a "seamless" trading area and concludes that "NYISO has not demonstrated that a seamless, virtual RTO, even were it to be achieved, would be the functional equivalent of a single Northeastern RTO." The NYISO Order did not indicate what criteria it evaluated in reaching this conclusion.

The Commission's conclusions with respect to these issues are arbitrary and capricious for a number of reasons and should be overturned on rehearing. First, the Commission has failed to explain why it is necessary to have a single RTO for each of the four putative "natural markets." Order No. 2000 does not require RTOs to operate markets, and the regulations promulgated thereunder require only that RTOs have sufficient size to "**support** efficient and non-discriminatory power markets," (emphasis added)[80] not that they entirely encompass such markets.

Second, the Commission has relied on stale information. Its decision is based on information about the MOU process that was current when the NYISO answered certain protests of its RTO filing, *i.e.,* it considers the state of the record as of March 2001. The Commission has

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78 NYISO Order, *slip op.* at 13.

79 *Id.*

80 18 C.F.R. § 35.34(j)(2) (2000).

ignored the substantial progress made during intervening months. For example, it disregards: (i) the planned near-term implementation of an "Open-Scheduling System" that will allow for one-stop shopping and scheduling in three Northeastern ISO markets and adjoining areas; (ii) the three ISOs' commitment to develop uniform installed capacity market rules; (iii) the NYISO's commitment to either implement a mechanism to reconcile its practice of allowing financial reservations at external interfaces with ISO-NE's and PJM's use of a physical reservation system at the interfaces, or adopt a physical reservation system itself; (v) PJM's and ISO-NE's efforts to develop bid-based reserves markets with the NYISO's assistance; and (vi) the NYISO's support for a MOU "revitalization" proposal that would make structural enhancements to expedite the resolution of "seams" issues and harmonize internal ISO market rules.[81] These successes were not part of the record in this proceeding, since the Commission took six months to act on the Joint Filing and did not invite supplemental information during the interim. However, they were discussed in other proceedings, most notably the recent "seams" technical conference, in which all of the Commissioners participated.[82] The Commission's failure to account for information of which it had actual knowledge is inconsistent with a reasoned decisionmaking process.

Third, the Commission's recitation of supposedly "balkanized" Northeastern market rules is equally dated. For example, concerns over "limits placed on ramping rates for external transactions,"[83] have been successfully addressed, while the ISOs are moving towards common reserves market products. Similarly, the only evidence that the Commission cites for its

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81 *See, e.g., Comments of the Member Systems*, Docket No. PL01-5-000 at 4-7, 11-17 (July 2, 2001) (Describing a "MOU Revitalization Plan" that the NYISO accepted in principle.)

82 *See, e.g., Post-Technical Conference Comments of the New York Independent System Operator, Inc.,* Docket No. PL01-5-000 at 2-6 (July 2, 2001).

83 NYISO Order, *slip op.* at 12.

suggestion that "balkanized" market rules may discourage trade is a March, 2000 letter from PJM warning that PJM would discontinue prescheduling transactions with the NYISO due to the frequency of curtailments by the NYISO.[84] As the NYISO has previously explained to the Commission, PJM's concerns have long-since been addressed and the threatened discontinuance of inter-ISO transactions never took place.[85]

Fourth, because the Commission has made so many factually unsubstantiated assumptions, and ignored so much relevant information, it has not given reasoned consideration to the possibility that a "virtual RTO" framework would capture the (presumed) benefits of a single RTO more quickly and inexpensively than a forced merger. The NYISO proposed a virtual RTO model, pursuant to which the three ISOs would administer standardized, and, when appropriate fully integrated, markets, and eliminate all inconsistent seams practices in the Joint Filing[86] and respectfully asks that the Commission reconsider it on rehearing. To reiterate, because the physical interconnections between the ISOs are small relative to the size of their individual markets, and because those interties are normally fully, or nearly fully, utilized, an ISO merger is unlikely to result in substantial increases in trade or to accelerate the development of a larger "seamless trading area." After the consummation of a merger, there will continue to be three distinct markets within the Northeast's supposed natural market. At the same time, a merger would, as the Commission admits, entail substantial "start-up" costs. and

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84 NYISO Order, *slip op.* at 12.

85 *See New York Independent System Operator, Inc.,* 92 FERC ¶ 61,073 at 61,310 (2000) (summarizing the NYISO's response to PJM's concerns and PJM's endorsement of the NYISO's response.)

86 Joint Filing at 17-18, 20-22; NYISO Answer at 12-20.

force parties to address difficult structural issues, *e.g.,* governance and cost allocation, that have little effect on markets.[87]

By contrast, there would be as many trading opportunities under a virtual RTO framework as there would be under a single RTO. A virtual RTO could bring the benefits the Commission anticipates far less expensively and with much less controversy than a merger. The Commission has a responsibility to fairly evaluate these cost and benefit considerations, rather than presuming that a virtual RTO would necessarily be inadequate.

On rehearing, the Commission should reconsider the virtual RTO alternative. It must be open to the possibility that the public interest may be better served, at least during a transitional period, by having three separate Northeastern RTOs administering integrated markets than it would be by trying to build a single RTO and a single market.[88] Moreover, if the Commission continues to have concerns that the NYISO has not made a sufficiently strong demonstration that a virtual RTO would be the "functional equivalent" of a single RTO, it should provide guidance as to what sort of showing it expects. Although Order No. 2000 clearly indicates that RTO proposals that rely on "effective scope" can be approved, it does not describe the criteria the Commission will use to evaluate "functional equivalence" proposals. Clarifying this point and, if necessary, affording the NYISO a reasonable opportunity to make a functional equivalence demonstration, will ultimately help the Commission make the best possible decision.

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[87] The NYISO Order and the Mediation Order are already having this effect as certain stakeholders insist on shifting resources to structural issues which may well cause important market enhancements to be delayed.

[88] The joint study of the feasibility of establishing a single Northeastern Day-Ahead energy market, that was developed by the NYISO, ISO-NE and the IMO, is an example of the kind of analysis the Commission should be willing to conduct. That study carefully reviewed the costs and benefits of alternative plans for achieving a single market and came to a reasonable conclusion. The study was appended to the Joint Filing as Attachment VI.

Conversely, rejecting the virtual RTO proposal without explaining why it is deficient, or indicating how it might be made compliant, is arbitrary and capricious. It would also effectively, and inappropriately, eliminate Order No. 2000's effective scope provisions.

Fifth, the Commission has not considered possible RTO alternatives other than the virtual RTO proposal at all. For example, the Commission could have addressed the problems it perceives with the consequences of "balkanized" market rules by encouraging the creation of an entity empowered to identify and ameliorate impediments to inter-ISO transactions. Such an entity could be created with none of the expense, disruption and controversy of a forced ISO merger and could potentially accomplish the Commission's policy goals much faster and with far less cost.

Sixth, contrary to Order No. 2000, the Commission has ignored the possibility that a Northeast RTO would be so large as to be inefficient, excessively remote from its stakeholders and insufficiently knowledgeable about local operational realities to perform its functions effectively.[89] The Commission should at least offer a reasonable explanation of why it does not believe these potential difficulties will pose operational problems if a Northeast RTO were established.

Seventh, and finally, the Commission's decision that there must be a single RTO for the Northeast's "natural market" is inconsistent with its tolerance for two "sub-regional" RTOs in the "Midwest."[90] If the Commission's very recent ruling that the Northeast and Midwest constitute distinct natural markets is correct, a point which the NYISO disputes, then it should

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[89] *See* Order No. 2000 at 31,080-81 (noting comments that "bigger is not necessarily better" and that there are factors which limit RTO size.)

[90] *See Illinois Power Co., et al.,* 95 FERC ¶ 61,183 (2001); *reh'g denied*, 96 FERC ¶ 61,026 (2001) (approving the Alliance - Midwest ISO settlement agreement.)

apply consistently its rule that each natural market may only have a single RTO. If it is acceptable for the "Midwest" to satisfy this rule by having multiple RTOs bound together by coordination agreements, then it should be equally acceptable for the Northeast to have such an arrangement.[91] Given its Midwestern precedent, it is arbitrary for the Commission to deny the NYISO and other Northeastern stakeholders an opportunity to strengthen the existing MOU process, a relatively simple task that had already been agreed to, and evolve towards the Midwest's multiple RTO model.[92]

In light of the errors described above, the NYISO respectfully submits that the Commission should reverse its arbitrary and capricious conclusion that there must be a single RTO in the Northeast. It should also reconsider its rejection of the virtual RTO proposal.

B. THE COMMISSION'S ATTEMPT TO MANDATE THE FORMATION OF A NORTHEAST RTO IS INCONSISTENT WITH ORDER NO. 2000 AND BEYOND THE SCOPE OF ITS AUTHORITY UNDER THE FEDERAL POWER ACT

In Order No. 2000, the Commission adopted a voluntary approach to RTO formation, while recognizing that its authority to mandate RTO participation on a generic basis was questionable and that any effort to assert such authority was likely to result in costly and slow litigation.[93] The Commission left open the possibility that it might invoke its authority under FPA Sections 205 and 206 to order an individual utility to join an RTO "upon finding that the

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91 The NYISO is not taking the position that either the Alliance RTO or the Midwest ISO should be denied RTO status or forced to merge with other entities. It is simply questioning the Commission's rationale for concluding that "the Northeast" must have a single RTO.

92 It is also arbitrary for the Commission to denigrate the MOU process in comparison to the Midwestern settlement arrangement without acknowledging that the Northeastern ISOs must resolve a greater number of difficult because they administer operational energy markets, whereas the Midwestern entities will not perform market functions.

93 *See* Order No. 2000 at 31,033- 34; Order No. 2000-A at 31-357-58.

public utility was engaging in unjust, unreasonable, unduly discriminatory or anticompetitive practices, and that participation in an RTO was a reasonable remedy for that unlawful behavior."[94] It added that if it decided "to impose such a remedy in a particular case, any aggrieved party would have the right to challenge the lawfulness of that remedy to the extent permitted by law."[95]

The NYISO Order directly contravenes Order No. 2000 and abandons voluntariness by holding that the NYISO "**must** work with its neighbors to form a single, fully integrated RTO with a single set of market rules and one market design in the Northeast." (emphasis added).[96] Similarly imperative language appears in the Mediation Order.[97] Although neither the NYISO Order, nor any of the Commission's other recent issuances, acknowledge that a major policy shift has taken place, the Commission has nonetheless mandated that there be a single RTO in the "Northeast." In so doing, the Commission has exceeded its authority.

The Commission's attempt to force public utilities to join an RTO is unlawful under the FPA because it exceeds the Commission's authority under Section 202(a). That provision states that "[t]he Commission is empowered and directed to divide the country into regional districts for the **voluntary** interconnection and coordination of facilities for the generation, transmission and sale of electric energy . . . ." (emphasis added).[98] Order No. 2000 specifically invoked

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94 *See* Order No. 2000 at 31,043; Order No. 2000-A at 31,360.

95 Order No. 2000-A at 31,360.

96 NYISO Order, *slip op.* at 13; *see also* NYISO Order, *slip op.* at 2 ("NYISO must negotiate with its neighbors and trading partners to form a single Northeastern RTO.")

97 *See* Mediation Order, *slip op.* at 1 ("[T]he Commission concludes that it is necessary that the three independent system operators in the Northeastern United States combine to form one RTO . . . . In this order, the Commission initiates mediation for the purpose of facilitating the formation of a single RTO for the Northeastern United States.")

98 16 U.S.C. § 824a(a).

Section 202(a) as one of the statutory bases for the Commission's authority to encourage RTO formation.[99] This was entirely appropriate because Order No. 2000 called for the voluntary creation of RTOs. Because Section 202(a)'s language is explicitly voluntary, however, it does not allow the Commission to force public utilities into "regional districts" for the coordination of their transmission facilities or the sale of energy. Any possible ambiguity on this point is eliminated by the relevant legislative history, which clearly rejects any suggestion that public utilities might be forced into regional districts.[100] Courts have likewise affirmed that Section 202(a) does not authorize the Commission to compel action.[101]

Moreover, because Section 202(a) restricts the Commission to encouraging the voluntary formation of regional coordination districts, the Commission may not mandate RTO formation pursuant to its remedial authority under Sections 205, 206 or 309. The United States Supreme Court has previously indicated that the Commission's authority under the Federal Power Act and the Natural Gas Act must be construed as a whole and not merely as isolated grants of authority.[102] "If possible all sections of the Act must be reconciled so as to produce a symmetrical whole."[103] Thus, the Commission's authority to take remedial action under Sections 205, 206 or 309 must be construed in light of Section 202(a) and cannot be read in a manner that would permit the Commission to mandate RTO formation.

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99 *See* Order No. 2000 at 30,993.

100 *See, e.g.,* H.R. Rep. 74-318 at 8, 27 (1935); *Congressional Record* -- House p. 10378 (June 28, 1935) ("[A]fter these districts are created, the question of interconnection and coordination within the district . . . is *left entirely to voluntary agreements between the utilities*.") (emphasis added).

101 *See, e.g., Otter Tail Power Co. v. United States*, 410 U.S. 366 (!973); *Central Iowa Power Cooperative v. FERC*, 606 F. 2d 1156 (D.C. Cir. 1979).

102 *See Federal Power Com'n v. Panhandle Eastern Pipeline Co.*, 337 U.S. 498, 514 (1949).

103 *Id.*

The Commission itself recently endorsed this principle in its order establishing the scope of and methodology for calculating refunds for California spot market transactions.[104] In that order, the Commission concluded that it could not interpret Section 309 to give itself additional refund authority beyond the scope of the refund authority explicitly conferred by Section 206.[105] The Commission should adhere to the same principle with respect to Section 202(a).

Even absent Section 202(a), the Commission could not require the establishment of a Northeast RTO pursuant to Sections 205 or 206 without finding, based on record evidence, that all of the Northeast's public utilities, including the ISOs, were engaging in unjust, unreasonable, unduly discriminatory or anticompetitive practices, and that mandating the formation of an RTO was an appropriate remedy. The Commission acknowledged as much in Order No. 2000 when it noted that it would only attempt to require an individual utility to join an RTO "upon finding that the public utility was engaging in unjust, unreasonable, unduly discriminatory or anticompetitive practices, and that participation in an RTO was a reasonable remedy for that unlawful behavior."[106] The Commission has made no such findings in this proceeding. Indeed, it does not even mention Section 205 or 206. Nor does it provide any other basis to justify its actions.

Finally, the NYISO Order's requirement violates FPA Section 203. That provision gives the Commission authority to review voluntary proposals by public utilities to transfer ownership of or control over their Commission-jurisdictional transmission assets through mergers and other dispositions (including transfers to RTOs). It does not empower the Commission to mandate dispositions that public utilities do not propose themselves. The Commission may not

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104 *San Diego Gas & Electric Co., et al.*, 96 FERC ¶ 61,120 (2001).

105 *San Diego Gas & Electric Co., et al.*, *slip op.* at 20-21.

106 *See* Order No. 2000 at 31,043; Order No. 2000-A at 31,360.

circumvent this restriction simply because it believes combining the ISOs is good policy any more than it could justify requiring two vertically-integrated public utilities to merge because the it believed a merger would result in increased economic efficiency. Nevertheless, the NYISO Order will inevitably require that the NYISO, which is a "public utility" by virtue of its operational control over Commission-jurisdictional facilities, will have to involuntarily transfer control over those facilities to a new RTO. Moreover, the Member Systems will also be required to involuntarily join a new entity.

C. THE COMMISSION'S CONCLUSION THAT THE PJM SOFTWARE AND MARKET DESIGN IS AN APPROPRIATE PLATFORM FOR THE ENTIRE "NORTHEAST" IS UNLAWFUL, ARBITRARY AND CAPRICIOUS

The NYISO Order requires the NYISO, and other Northeastern stakeholders, to formulate "a single set of market rules and one market design in the Northeast."[107] The order further specifies that this new market design is to be based on the PJM "platform," but adds that "PJM must be open to changes and improvements suggested by others," and encourages "the three ISOs to look at the best practice in all three ISOs to develop market rules for a Northeast RTO."[108]

As an initial matter, the Commission's requirement that the NYISO adopt a new market design based on the PJM platform is unlawful because it is beyond the scope of this proceeding. Because Order No. 2000 did not require an analysis of the NYISO-administered markets' performance, the NYISO did not address market design issues in depth, or prepare a detailed comparison of the NYISO and PJM designs in the Joint Filing or in subsequent pleadings in this

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107 NYISO Order, *slip op.* at 13.

108 *Id.* at 13-14.

proceeding.[109] Nevertheless, the NYISO Order unexpectedly injected market design issues into this proceeding, by making an abrupt leap from the proposition that PJM's scope and configuration are a "platform that must be built upon" to a conclusion that PJM's market design must be the platform. Such a conclusion is beyond the scope of this proceeding and inconsistent with the NYISO's due process rights.

The Commission also has not offered record evidence demonstrating that the NYISO's market design is sufficiently flawed, unjust, unreasonable and/or discriminatory to justify forcing the NYISO to move to a PJM "platform." Although the NYISO Order does not state what authority the Commission is relying on to support this mandate, it is presumably depending on Sections 205 or 206 of the FPA. As was noted above, however, the Commission cannot act under these provisions unless it has made various findings of fact that have simply not been made in this proceeding. The Commission cannot lawfully exercise whatever authority it may have under FPA Sections 205 and 206 to require the NYISO to modify its tariffs, software and other systems and adopt PJM's without a record showing that such a directive is necessary to remedy serious problems or abuses.

In addition, the NYISO Order's decision to compel the adoption of PJM as a platform is arbitrary and capricious. Although the NYISO Order appears, at first glance, to take a flexible approach to market design issues, by allowing for "best practices" modifications, its presumption that PJM's systems are an appropriate platform for the Northeast is not the product of a reasoned decisionmaking process. PJM's market rules and software have worked well in PJM. ISO-NE has seen fit to adapt them for use in New England, albeit over a two year period and with certain

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[109] *See, e.g.,* Order No. 2000 at 31,229 (noting that RTOs are not required to establish PXs or perform PX functions). The Commission has granted provisional or conditional RTO status to GridSouth, the Alliance RTO and RTO West which do not operate centralized markets.

necessary modifications.[110] There are also unquestionably fundamental similarities between the current New York and PJM market rules and software. However, as the NYISO has previously explained,[111] if the NYISO were compelled to adopt PJM's systems without major changes, it is quite possible that reliability would be jeopardized and the NYISO's markets would be disrupted.

PJM's transmission system and markets are significantly different from New York's and the differences are reflected in the two ISOs' market designs. It therefore makes no more sense to impose PJM's platform on New York than it would to impose New York's platform on PJM. Each design was intended to serve a specific region, and it is quite possible that a mostly, or entirely, new design will be necessary to serve a Northeast-wide RTO. Each market design has some economic advantages when compared to the other. The Commission had no basis to choose one over the other without conducting a careful review to determine the most appropriate design for the Northeast.

Specifically, the New York State transmission system and markets face a number of conditions that either do not exist, or are much less severe, in PJM and New England. These include: (i) the existence of severe congestion on the New York State transmission system, especially at the Central-East constraint; (ii) "hard" locational installed capacity and operating reserve requirements in New York City and Long Island; (iii) the fact that most supply in New York is controlled by merchant suppliers that have different incentives and tend to behave differently than suppliers in PJM, many of which are vertically-integrated utilities, that retain

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110 *But see, New England Power Pool, et. al.*, 96 FERC ¶ 61,100 (2001) (finding ISO-NE's proposal to adopt PJM's rules and software to have been mooted by the Commssion's recent RTO orders.)

111 *See, e.g.,* NYISO Answer at 28-29; *New York Independent System Operator, Inc.'s Reply Comments*, Docket No. RM99-2 at 8 (May 14, 2001).

their traditional "obligation to serve," or utility subsidiaries; (iv) the fact that New York is capacity deficient in the critical downstate area, whereas PJM enjoys a substantial surplus; and (v) the existence of a large number of "fixed block" gas turbine units in downstate New York that pose a variety of dispatching complications.

These differences are a large part of the reason why the NYISO market design and software includes sophisticated features that PJM's lacks, such as: (i) bid-based reserves markets that are simultaneously co-optimized with energy and reserves; (ii) a formal, automated hour-ahead evaluation process, *i.e.,* its Balancing Market Evaluation ("BME") to adjust interchange and ancillary services schedules and start fixed block units; (iii) special locational reserve rules, and software capable of implementing them on a fully automated basis; and (iv) special rules to address the dispatch and pricing problems associated with fixed block units. In addition, although PJM serves a larger load than New York, there has been much greater supply divestiture in New York and PJM's markets have a much smaller transactional volume than the NYISO's.[112] PJM's systems have never had to manage the kind of transactional volume that the NYISO's systems routinely handle.

The Commission has not evaluated whether it would be most effective and least expensive to incorporate features addressing these differences into PJM's software and market rules or to take some other approach, *e.g.,* developing new software or coordinating existing systems. It has also not considered whether the PJM systems could, even with substantial modifications, reliably and efficiently administer the current New York, PJM and New England systems at the same time. The Commission's failure to adequately review these issues, or to

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[112] For example, in 2000 there were $5.2 billion worth of transactions in the NYISO-administered markets and $1.7 billion in PJM, even though far more energy flows through the PJM transmission system.

sufficiently explain its examination of them, is arbitrary and capricious. The Commission should address these issues on rehearing.

D. IF ORDER NO. 2000 IS TRULY VOLUNTARY, THEN THE COMMISSION ERRED BY REFUSING TO ALLOW THE NYISO TO SUBMIT A COMPLIANCE FILING

Consistent with its embrace of a voluntary RTO formation policy, Order No. 2000 does not threaten to punish RTO applicants whose applications are rejected by forcing them to participate in RTOs that are not of their choosing. Instead, under Order No. 2000, rejected applicants will not be eligible for innovative ratemaking treatments. The Commission also reserved the right to deny certain benefits, such as market-based rate authorization or merger approvals, to utilities that are not part of Commission-approved RTO although it stopped short of making such sanctions a generic policy.[113] Thus, Order No. 2000 stated:

> Proposals that do not satisfy the minimum characteristics and functions will not be approved as RTOs. That does not mean that such a proposal would be summarily rejected; in fact, it may still be an improvement over the status quo as long as it is consistent with FPA requirements. However, it may be questioned the extent to which entities that are not participating in RTOs have acted to eliminate the impediments to competition we have identified in the Final Rule.[114]

In keeping with Order No. 2000's non-punitive approach, previous Commission RTO orders that have found flaws in RTO applications have rejected them without prejudice and allowed the applicants to submit compliance filings or revised proposals.

By contrast, the NYISO Order rejects the Joint Filing and directs the applicants to instead develop a single Northeast RTO. This is fundamentally inconsistent with Commission precedent and Order No. 2000. If the Commission persists in barring the NYISO from making a

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113 *See* Order No. 2000 at 31,034; Order No. 2000-A at 31,358.

114 Order No. 2000 at 31,232.

compliance filing, it is unlawfully transforming Order No. 2000 from a voluntary to a mandatory rule without following the appropriate APA procedures.

The Commission's decision is also unreasonable because the Joint Filing was crafted, in accordance with Order No. 2000, through a genuine collaborative process, while a number of other approved RTO proposals were developed with far less stakeholder input. In addition, precluding the NYISO from making a compliance filing, particularly with respect to the question of whether a virtual RTO could be at least the "practical equivalent" of a single RTO represents an arbitrary and capricious refusal to contemplate reasonable alternatives. It would also be irrational and inefficient to require the NYISO and other stakeholders to essentially start over without considering whether relatively modest changes could bring the NYISO into full compliance with Order No. 2000.

E. THE COMMISSION'S DETERMINATION THAT THE NYISO LACKS SUFFICIENT INDEPENDENCE TO BE AN RTO WAS ARBITRARY AND CAPRICIOUS

The Commission has previously held[115] that the NYISO's governance structure, pursuant to which authority is shared among an independent, non-stakeholder Board of Directors, and a participatory democracy of market participants, governmental entities and citizens' groups, was consistent with Order No. 888's requirement that ISOs have governance structures which ensure their independence.[116] Order No. 2000 gave every indication that ISO governance structures which complied with Order No. 888's "ISO Principles," would be acceptable pursuant to Order No. 2000's independence characteristic. The Commission made these statements at the same

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115 *See Central Hudson Gas & Electric Corp.,* 88 FERC ¶ 61,229 (1999).

116 Order No. 888 at 31,730-31.

time that it explicitly recognized the role played by stakeholders in the NYISO's currently effective governance system.[117] Order No. 2000 also specified that:

> What the Commission has approved for ISO forms of governance can be used as models for governance of RTOs that are ISOs. Nothing in this Rule prohibits the types of independent governance structures we have approved to date. All of the ISOs approved to date, except one [*i.e.,* California] have a two-tier form of governance wherein a non-stakeholder board at the top generally has final decision-making authority on most issues. Below this board are advisory groups or committees comprised of stakeholders that provide advice and may share some decision-making authority. With regard to the second-tier, the Commission has required that no one constituency in any group or committee be allowed to dominate the recommendation or decision-making process over the objections of the other classes, and that no one class holds veto power over the objections of the other classes.[118]

The NYISO Order ignores these principles and, in an abrupt about face, states that its "approval of the governance of an ISO is not equivalent to Commission approval of the independence of an RTO."[119] It therefore directs the NYISO and other Northeastern stakeholders to develop a single RTO governance model in which stakeholders will play "an advisory role, at most."[120] The Commission has offered absolutely no explanation for these decisions. Its ISO governance requirement exists in order to ensure that ISOs are sufficiently independent. Given that the existing Northeastern ISOs perform both the RTO functions that Order No. 2000 requires, as well as market-related functions that go beyond its requirements, the Commission's failure to offer a reasoned explanation is arbitrary and capricious. Moreover, even if the Commission had adequately explained its rationale for rejecting the NYISO's current governance system, it should, consistent with Order No. 2000's voluntary approach to RTO

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117 Order No. 2000 at 31,073, n. 329.

118 Order No. 2000 at 31,232.

119 NYISO Order, *slip op.* at 7.

120 NYISO Order, *slip op.* at 8.

formation, have given the NYISO a chance to correct the problems and make a compliance filing. Since it would very likely have been much easier to change the NYISO's current system than it will be to create an entirely new one for a much larger entity, the Commission's failure to consider this alternative is itself arbitrary and capricious.

F. THE NYISO ORDER CONTAINS SEVERAL OTHER ERRORS WHICH SHOULD BE CORRECTED ON REHEARING

1. Operational Authority

The NYISO Order holds that the NYISO's RTO proposal does "not fully meet" Order No. 2000's "operational authority" requirements. The Commission asserts that it has reached this conclusion in part because it is concerned that the Member Systems' authority to "re-assert operational control" of their transmission facilities during emergency periods could allow them to "affect operations of the transmission system when it may be most constrained or facing peak demands."[121] The Commission also appears to be concerned that the NYISO lacks authority over certain transmission facilities.[122]

The Commission's conclusion regarding the Member Systems emergency authority appears to be based on a factual misunderstanding. Pursuant to Section 5.3.1 of the NYISO's Market Administration and Control Area Services Tariff, the Member Systems may only regain control over their facilities in very limited circumstances. Specifically:

> [i]f a communication or computer system malfunction results in the ISO's inability to operate the [New York Control Area] in accordance with the ISO Procedures or under approved testing procedures, the ISO will direct the Transmission Owners to assume the responsibility to operate their respective systems in accordance with Good Utility Practice to facilitate the operation of the [New York Control Area] in a safe and reliable manner ("Back-up Operation").

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121 NYISO Order, *slip op.* at 15.

122 *Id.* at 15-16.

Thus the Member Systems may only "re-assert operational control" over their transmission facilities in the event of a major malfunction that prevents the NYISO from performing its duties. The narrow scope of this requirement, coupled with the fact that the Member Systems may only re-assert control if the NYISO directs them to do so, means that the Member Systems cannot re-assert control simply because of severe congestion or high demands. The Commission should correct this error on rehearing.

The Commission's concerns regarding the NYISO's lack of control over certain transmission facilities are unclear because it has not specified, with the exception of certain phase-angle regulators ("PARS"), which facilities it believes the NYISO should control. The NYISO Order also states that the NYISO must justify its lack of control over certain facilities but does not provide an opportunity for it to do so. If the Commission believes that the NYISO must have control over certain PARS, it should have given the NYISO an opportunity to make a compliance filing either explaining that it has reached an agreement with the relevant Member System to obtain control over them, or justifying its lack of authority. The Commission should take a similar approach regarding any other facilities that it concludes the NYISO needs to control. Alternatively, if the Commission wishes to establish a presumption that the NYISO should control every transmission, or "transmission-related" facility in New York State, the NYISO respectfully asks that the Commission say so clearly and allow the NYISO to prepare a response.

More fundamentally, the NYISO Order's assertion that "[a]n RTO proposal must explain why certain transmission facilities or transmission related facilities are excluded from its operational authority" is inconsistent with Order No. 2000. There the Commission required that an RTO "have operational authority for all transmission facilities under its control" and that it

"also must be the security coordinator for its region."[123] Similarly, the regulatory text promulgated pursuant to Order No. 2000 states:

> *Operational authority.* The Regional Transmission Organization must have operational authority for all transmission facilities under its control. The Regional Transmission Organization must include, as part of its demonstration of operational authority, a demonstration that it meets the following:
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> (i) If any operational functions are delegated to, or shared with, entities other than the Regional Transmission Organization, the Regional Transmission Organization must ensure that this sharing of operational authority will not adversely affect reliability or provide any market participant with an unfair competitive advantage. Within two years after initial operation as a Regional Transmission Organization, the Regional Transmission Organization must prepare a public report that assesses whether any division of operational authority hinders the Regional Transmission Organization in providing reliable, non-discriminatory and efficiently priced transmission service.
>
> (ii) The Regional Transmission Organization must be the security coordinator for the facilities that it controls.[124]

The Joint Filing was prepared in order to ensure the NYISO's compliance with Order No. 2000's stated requirements. Order No. 2000 does not require that an RTO control every transmission facility, or "transmission-related" facility, within its boundaries, as the NYISO Order appears to assume. Instead, it requires that an RTO be the security coordinator for its region, a function which the NYISO Order concedes that the NYISO is. It also requires that an RTO have full operational control over the transmission facilities that are its responsibility, which the NYISO already possesses.[125] Lastly, Order No. 2000 requires that RTOs submit a report describing whether any division of operational authority is hindering its performance within two years of its commencement of operations as an RTO. The Joint Filing committed the NYISO to submit such a report. Inexplicably, the Commission criticized this pledge on the

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123 Order No. 2000 at 31,090.

124 18 C.F.R. § 34.34(j)(3) (2001).

125 Joint Filing at 22-23.

ground that it did not "substitute for seeking, at start-up, to include within its control all facilities necessary in order to provide transmission service."[126] Such criticism is unreasonable both because it fails to recognize why the NYISO mentioned the two-year report, and because the NYISO has already provided reliable transmission service for more than a year and a half.

In addition, the Commission has failed to explain why the NYISO's operational authority is inadequate given its earlier holding that the NYISO complied with Order No. 888's requirement that an ISO "have control over the operation of interconnected transmission facilities within its region."[127] As with the Commission's holding that its approval of an ISO's independence is not tantamount to its approval of RTO independence, the Commission should explain why its prior holding that the NYISO had sufficient operational authority, by virtue of its control over a specific, Commission-approved list of transmission facilities, should be reversed, especially since the NYISO is operating successfully.

In short, the Commission's conclusions regarding the NYISO's operational authority reflect at least one basic factual error and effectively punish the NYISO for failing to comply with an ambiguous requirement that does not appear to be included in Order No. 2000. This is unlawful, arbitrary, capricious and inconsistent with a reasoned decisionmaking process. The Commission has also failed to provide a reasoned explanation of its decisions. The Commission should revisit this issue on rehearing and either find the NYISO to be in full compliance with Order No. 2000 or provide further guidance and permit the NYISO to make a compliance filing that will bring it into full compliance.

2. Tariff Administration and Design

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126 NYISO Order, *slip op.* at 16.

127 *See Central Hudson Gas & Electric Corp., et al.,* 83 FERC ¶ 61,352 at 62,413-14 (1998).

The NYISO Order asserts that the NYISO is not the sole administrator of its open-access transmission tariff and lacks independent and exclusive authority to file tariff changes because its independent Board can only make permanently effective tariff filings if it has the support of the stakeholder Management Committee.[128] The Commission's conclusion on this issue is closely related to its determination that the NYISO is insufficiently independent for Order No. 2000 purposes and is therefore of questionable merit for the same reasons.[129] Moreover, consistent with the voluntary nature of Order No. 2000, the Commission should have afforded the NYISO an opportunity to correct, or justify, any perceived deficiencies in this area.

3. Congestion Management

The NYISO Order asserts that the NYISO's current "congestion management system will need to be redesigned to take into consideration the requirements of a larger market."[130] It notes that a "number of market participants filed complaints in regard to the NYISO's congestion management practices."[131] It also claims that the NYISO's Locational-Based Marginal Pricing ("LBMP") congestion management system is too "inward-looking" compared to PJM's Locational Marginal Pricing ("LMP") system.[132] The NYISO disagrees with each of these statements.

First, the Commission's statement that the NYISO's congestion management system is overly "inward focused" is inaccurate and inadequately explained. The Commission states that it

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128 NYISO Order, *slip op.* at 19.

129 NYISO Order, *slip op.* at 7-8.

130 NYISO Order, *slip op.* at 22.

131 *Id.*

132 *Id.*

agrees with Enron Power Marketing, Inc.'s arguments on this subject, but does not appear to have fully evaluated them. According to the Commission's summary:

> Enron claims that the NYISO has not adopted a market mechanism for managing inter-RTO congestion that recognizes firm transmission rights. Enron notes that the [Transmission Congestion Contract ("TCC")], when added to the LBMP to create financial rights, may arguably work intra-RTO, but that such mechanisms do not allow for exchanges between RTOs because they are coordinated on a physical basis and because each RTO uses a different market model to calculate prices. . . . Enron says that the PJM congestion management system works through the use of the LMP and a fixed transmission right (FTR), which Enron notes is a financial hedge.

In addressing this argument, the Commission appears to have forgotten its past holdings that LBMP and LMP are technically very similar and that LBMP includes features which LMP lacks.[133] Likewise, it does not seem to recognize that TCCs and FTRs are very similar financial hedging mechanisms. More fundamentally, there is no evidence, and Enron has presented none, which suggests that LBMP is functioning poorly. While the NYISO has experienced scheduling and curtailment problems at its external interfaces these problems involved the inter-ISO checkout process, BME errors and other factors, not the NYISO's congestion management practices.[134]

Second, the Commission's assumption that LBMP must be redesigned to accommodate a larger market implicitly concludes that LMP and not LBMP should be the platform for a Northeast RTO's congestion management system. This conclusion is closely intertwined with, and therefore suffers from the same flaws as, the Commission's decision to make PJM's market rules and software the "platform" for the Northeast. Briefly, the Commission's decision is

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133 *See Central Hudson Gas & Electric Corp., et al.,* 86 FERC ¶ 61,062 at 61,223 (1999)

134 As the NYISO has explained in other proceedings most of these problems have been fixed while the remainder are being addressed through the NYISO's various inter-regional coordination efforts.

premature, not supported by the record, and ill-advised. If the Commission continues to believe that there should be a single Northeastern RTO, it should support the implementation of a congestion management system that is found, after a rational review, to best meet the needs of the entire Northeast.

Third, the complaints that the Commission cites to suggest that there are flaws in the NYISO's congestion management rules actually had little or nothing to do with congestion management and instead focused on other problems that have since been successfully addressed. Specifically, NRG's March 8, 2000 complaint in Docket No. EL01-49-000 involved allegations that the NYISO had improperly corrected prices that were erroneously calculated due to software flaws that have nothing to do with congestion management.[135] These flaws were subsequently corrected. Niagara Mohawk Energy Marketing, Inc.'s July 26, 2000 complaint in Docket No. EL00-82-000 had to do with a software problem that was causing the NYISO to erroneously curtail certain exports. This problem was completely eliminated a little more than a year ago.[136] Finally, the New York State Electric & Gas Corporation ("NYSEG") April 24, 2000 complaint, as amended May 10, 2000, in Docket Nos. EL01-70-000 and EL01-70-001, targeted a number of the NYISO's immediate post-implementation problems and market design flaws. NYSEG focused mainly on generator dispatching, price volatility, transaction scheduling (and BME),

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135 *See NRG Power Marketing, Inc. v. New York Independent System Operator, Inc.*, 92 FERC ¶ 61,060 (2000).

136 *See New York Independent System Operator, Inc.'s Notice Concerning Docket Nos. EL00-82-000, EL00-70-001 and ER00-3038-002* (August 10, 2000) (informing the Commission that the software problem which was the subject of the complaint in Docket No. EL00-82-000 was successfully corrected on August 4, 2000). The problem has not recurred since August, 2000. *See also, New York Independent System Operator, Inc.*, 93 FERC ¶61,142 (2000) (Acknowledging the NYISO's August 10 filing and stating that there was no need for further discussion of the issue raised in Docket No. EL00-82-000.)

software and billing problems.[137] LBMP was a very tangential issue and NYSEG's concerns regarding it have since been addressed. Thus, all of the precedent cited by the Commission is irrelevant to the Commission's conclusion that there are problems with the NYISO's LBMP congestion management system.

In short, the Commission's conclusions regarding the NYISO's congestion management practices are based on a number of factual misunderstandings. They are not the product of a reasoned decisionmaking process and must be revisited on rehearing.

4. Parallel Path Flows

The NYISO Order declares that although the NYISO has "addressed the issue of parallel path flows internal to its control area," it has not "addressed how parallel path flows would be internalized within the Northeast and neighboring regions" and, therefore, did not satisfy Order No. 2000's parallel path flow requirements. This finding is premised on the Commission's determination that the Northeast is a "natural market" and thus the only relevant region for RTO purposes. As was noted above, the Commission's underlying determination is highly questionable both as a matter of policy and law and should be reversed on rehearing. Because it was appropriate for the NYISO to define New York as the relevant RTO region, the fact that the NYISO did not propose to manage parallel path flows within the entire "Northeast" by the time it begins RTO operations is not inconsistent with Order No. 2000.

Pursuant to Order No. 2000, the NYISO has until December 15, 2004 to implement a system, in collaboration with its neighbors, for addressing parallel path flows affecting New

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[137] *See New York State Electric & Gas Corporation v. New York Independent System Operator, Inc.*, 92 FERC ¶ 61,073 (2000). (Listing the issues of concern to NYSEG.) As the Commission is aware, NYSEG's first allegation, *i.e.,* that imports into New York had become "unworkable," had to do with scheduling procedures and other seams issues rather than LBMP congestion management. These problems have also since been addressed.

York, New England, PJM, Ontario and the other regions that comprise the Eastern Interconnection.[138] The NYISO's proposal to address these inter-regional flows by participating in the Northeast Power Coordinating Council's ("NPCC") Lake Erie Emergency Re-Dispatch Agreement, the MAAC-ECAR-NPCC inter-regional transfer studies, the MOU process and various NERC initiatives is consistent with Order No. 2000. Thus, the Commission's decision to reject the NYISO's parallel path flow proposal was in error.

5. Transmission Expansion and Planning

The NYISO Order asserts that there are a number of problems with the "Consolidated Transmission Plan" ("CTP") that was included in the Joint Filing and consequently rejected the NYISO's transmission and expansion planning proposals.[139] Given, however, that Order No. 2000 does not require RTO applicants, or RTOs, to fully comply with its requirements until December 15, 2004, this deficiency is no basis for denying the NYISO RTO status. Instead, consistent with the voluntary nature of Order No. 2000, the Commission should permit the NYISO to develop a compliance filing that responds to the policy guidance provided by the NYISO Order. To the extent that the Commission's rejection of the Joint Filing was related to its rejection of the CTP the Commission has erred and should modify its conclusion on rehearing.

Similarly, it would be unreasonable for the Commission to penalize the NYISO for failing to submit a three-year plan with specific milestones describing how it would come into full compliance with Order No. 2000's requirements. The NYISO believed in good faith that the

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138 *See* 18 C.F.R. § 35.34(k)(3).

139 NYISO Order, *slip op.* at 40.

CTP proposal would be fully compliant once it was implemented and therefore did not think it necessary to submit a three-year plan.

6. Interregional Coordination

The NYISO Order states that the Commission is "not satisfied" with the MOU's progress on eliminating seams, or with the broader effort to create a single energy market in the Northeast. For the reasons set forth above, the NYISO disputes the Commission's characterization that the MOU process is inadequate as well as its assertions that the "scope of the proposed NYISO RTO is too small and the issues facing the Northeast would be better handled through an RTO that encompasses the entire Northeast region and in coordination with Canadian entities, rather than through the MOU process."[140] As the NYISO noted above, the Commission has relied on stale information about the MOU and has unfairly minimized its achievements.

Moreover, it is unreasonable for the Commission to construe Order No. 2000 as requiring that all reliability and market practices be fully integrated on the first day that an RTO commences operations. This is especially true with respect to reliability practices which are supposed to be integrated on an interconnection-wide basis. Consequently, it was inappropriate for the Commission to find the NYISO's inter-regional coordination efforts deficient because they were not yet entirely successful months more than five months before Order No. 2000's RTO start-up deadline. The Commission's use of stale information regarding the MOU process only exacerbates this problem.

The NYISO also respectfully reminds the Commission that it is unreasonable to complain about a lack of progress to date towards the establishment of a single market when Order No. 2000 called for the creation of a "seamless trading area," but did not attempt to define indivisible

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[140] NYISO Order, *slip op.* at 43-44.

natural markets. The NYISO has been attempting in good faith to comply with Order No. 2000's requirements, which allowed for great flexibility in achieving the goal of a seamless trading area. The NYISO could not have anticipated that the NYISO Order would supplement Order No. 2000 by mandating that this could only be accomplished through the formation of a single Northeastern RTO and market.

VI. CONCLUSION

WHEREFORE, for the foregoing reasons, the New York Independent System Operator, Inc. respectfully asks that the Commission grant its request for rehearing and reverse its: (i) decision regarding scope and configuration, (ii) determination that the Northeast constitutes a "natural market;" (iii) mandate that there be a single RTO in the Northeast; (iv) requirement that PJM's market rules and software be the "platform" for a Northeast RTO; and (v) conclusions regarding the NYISO's independence, operational authority, tariff filing authority, congestion management practices, parallel path flow procedures and inter-regional coordination efforts. The Commission should further clarify that any deficiencies with respect to parallel path flow management and transmission planning are not a barrier to becoming an RTO because Order No. 2000 does not require that these issues be resolved until 2004. The Commission should also either declare the NYISO to be an RTO, or permit it to make a compliance filing to correct any remaining deficiencies. Finally, if the Commission continues to believe that it should mandate the formation of a single RTO and prescribe its boundaries, it should, at a minimum, initiate a notice and comment rulemaking and more thoroughly evaluate all of the relevant issues.

Respectfully Submitted,

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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 Docket Nos. RT01-95-000 and RT01-99-000 in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 2010 (1999).

Dated at Washington, D.C. this 10th day of August, 2001.

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