UNITED STATES OF AMERICA 99 FERC ¶ 61,125
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

New York Independent System Operator, Inc. Docket No. ER00-1969-004 and
ER00-1969-011

ORDER ON REQUESTS FOR REHEARING

(Issued April 29, 2002)

In this order, we deny the request for rehearing of our November 8, 2001 order[1] filed by the New York Independent System Operator, Inc. (NYISO), but grant the request for rehearing of an order issued November 8, 2000,[2] filed by KeySpan-Ravenswood, Inc. (KeySpan). The November 8, 2001 Order denied rehearing of an order issued May 31, 2000,[3] in which we accepted the request of NYISO for bidding restrictions on its 10-minute non-spinning operating reserves (NSR) market on an interim basis. However, we rejected NYISO's requests to: (1) impose a bid cap on spinning reserves (SR), (2) re-bill for operating reserves over the period of March 1 through March 28, and (3) establish alternative dispute resolution (ADR) procedures to facilitate re-billing of rates charged over the period of January 29, through March 28. In the November 8, 2000 Order, the Commission, among other things, determined that May 31, 2000, should be the effective date for the tariff provision requiring that NSR suppliers be compensated for lost opportunity costs. We believe that our decision in this order will promote confidence in the NYISO-administered markets, which will increase supply, improve reliability, and in the long run, create more efficient energy prices.

---

[1]97 FERC ¶ 61,155 (2001).

[2]93 FERC ¶ 61,142 (2000).

[3]91 FERC ¶ 61,218 (2000).

NYISO's Request for Rehearing

Section 205 and Section 206 of the FPA

In its Federal Power Act (FPA) section 205 tariff filing made on March 27, 2000, NYISO requested that the Commission initiate an ADR settlement process through its Dispute Resolution Service (DRS) office in order for all parties participating in the 10 minute SR and NSR markets to come to a resolution of the appropriate amounts that should be billed and collected for the period from January 29 to March 28, 2000. NYISO also requested authority to bill and collect for both 10 minute SR and NSR for the period from March 1 to March 28, 2000, the proposed effective date of the prospective bid limitations, based on approximations of the prices, pending the outcome of the ADR settlement process

In the May 31 Order, the Commission allowed NYISO to impose a $2.52 bid cap on NSR effective March 28, 2000, the day after NYISO's filing, but denied the NYISO's request to initiate an ADR settlement process for the purpose of determining the correct charges to be billed for the January 29 to March 28 period, because it believed that such changes should be prospective. The Commission explained that customers cannot effectively revisit their economic decisions in these circumstances. The Commission recognized that NYISO is responsible for correcting prices that are calculated incorrectly and is permitted to make retroactive changes in order to correct mistakes in the computation or calculation of prices, within reason. But the Commission found that in this case NYISO was not proposing to correct prices that were calculated incorrectly, but to adjust prices to correct market-based rates through negotiations among the interested parties. Given the Commission's finding of concentration as well as other market flaws in the operation of NYISO's reserve markets, the Commission stated that it would be very difficult for NYISO, or any party, to simply recalculate the correct market-based rates.

On rehearing of the May 31 Order, the LSE Intervenors and NYISO argued that market-based pricing is permissible only when competitive market forces or adequate regulatory back-stops are in place. They asserted that, given the Commission's findings that called into question continued reliance on market-based pricing for NSR, section 205 of the FPA requires the Commission to allow the recalculation of rates for the prior periods at issue in this case.

In the November, 2001 Order, the Commission rejected these arguments stating that although the existing rate may have become unjust and unreasonable, changes in rates under section 206 of the FPA may be made effective only prospectively or during

the refund effective period.[4] The Commission further explained that even if it found that the rates charged were unjust and unreasonable, rate recalculation would be impermissible because the Commission's authority to order refunds is limited to the period after the refund effective date of the proceeding (for the 15 month period) or prospectively from the date of the Commission order resolving the dispute. With respect to the argument that the Commission should order re-billing in order to enforce NYISO's filed rate, the Commission stated that section 206 of the FPA does not permit the Commission to require refunds of unjust and unreasonable rates charged prior to a date 60 days after the filing of a complaint.

On rehearing of the November 2001 Order, NYISO argues that because it filed to establish a reserves bid cap pursuant to section 205 of the FPA in accordance with its approved market monitoring plan, the Commission erred in relying on section 206 to find that it could not authorize the retroactive application of mitigation measures for a demonstrated abuse of market power. In so arguing, NYISO quotes language in the May 31 Order and a prior Central Hudson order[5] that requires NYISO, if it detects the exercise of market power in the operating reserves market, to report to the Commission and recommend appropriate steps to mitigate such behavior. NYISO also describes the initial order approving its market monitoring plan,[6] which envisioned that NYISO would make section 205 filings requesting authorization to impose mitigation measures on a case-by-case basis whenever necessary. NYISO maintains that consistent with the Commission's responsibility to ensure that jurisdictional rates are just and reasonable, the authorization of market-based rates conditioned on market monitoring and mitigation should be seen as authorization only to charge market-based rates subject to reasonable mitigation measures as may be appropriate to ensure that rates are just and reasonable relative to market conditions prevailing from time to time.

In addition, NYISO cites the recent Order Establishing Refund Effective Date and Proposing to Revise Market-Based Rate Tariffs and Authorizations (Market-Based Rate

---

[4]Citing San Diego Gas & Electric Company v. Sellers of Energy Ancillary Service Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange, et al. (San Diego), 96 FERC 61,120, 61,505 (2001).

[5]Central Hudson Gas & Electric Corp., et al. (Central Hudson), 86 FERC ¶ 61,062 (1999).

[6]89 FERC ¶ 61,196 (1999).

Order)[7] which proposed a condition that would make a seller's market-based rate authority subject to refunds or other remedies as may be appropriate to address any anticompetitive behavior or exercise of market power. NYISO asserts that in this case, such refund authority was already applicable by virtue of the conditioning of market-based rates in New York on NYISO's market monitoring plan as approved by the Commission.

The Commission rejects these arguments. First, even though the dispute in this case originates with a section 205 filing, the Commission's use of San Diego, a section 206 proceeding, as supporting precedent is appropriate since section 206, like section 205, is forward looking consistent with the general scheme of the FPA. For both sections, an existing just and reasonable rate may only be changed prospectively after certain events occur, all of which can occur no sooner than the date the respective section 205 or 206 filing. In the case of section 205, a rate may be changed only after a section 205 filing is made, not prior to the date of the filing, as NYISO proposes here. In the case of section 206, the earliest date that the rate can be changed is, unless the Commission acts on the filing sooner, the refund effective date established pursuant to section 206(b).

The Commission also rejects the argument that the Commission made NYISO's operating reserves rates subject to refund when it accepted NYISO's (or Member Systems') ancillary service market proposal in Central Hudson, or when it accepted NYISO's market monitoring plan. The Market-Based Rate Order cited by NYISO is relevant in this regard although it does not support NYISO's argument. That order[8] shows clearly that when the Commission wishes to make a rate subject to refund, in that case under section 206, the Commission uses precise language to so indicate:

> Pursuant to FPA section 206, we are establishing a refund effective date 60 days from the date on which notice of initiation of this investigation is published in the Federal Register and seek comments on our proposal to revise all market-based rate tariffs and authorizations in effect to condition public utility sellers' market-based rate authority to prevent anticompetitive behavior or the exercise of market power. In particular, all such market-based rate tariffs and authorizations would be revised to include the following provision: "As a condition of obtaining and retaining market-based rate authority, the seller is prohibited from engaging in anticompetitive behavior or the exercise of market power. The seller's

[7] 97 FERC ¶ 61,220 (2001).

[8] 97 FERC at 61,976.

> market-based rate authority is subject to refunds or other remedies as may be appropriate to address any anticompetitive behavior or exercise of market power."

None of the prior orders concerning its operating reserves or market monitoring that NYISO cites contain such language or anything close to it. Rather, the Commission envisioned a process under which NYISO, if it identified a market flaw, would make a section 205 filing, and the flaw could then be remedied prospectively from a date no earlier than the date of that filing. That is how the Commission treated NYISO's March 27, 2000 section 205 tariff filing in this case. It is true that the Commission conditioned its initial approval of NYISO's operating reserves rates on NYISO having a market monitoring unit in place and filing certain reports, etc., but the Commission did not go the additional step of accepting those rates subject to refund for an indefinite period as NYISO argues. In fact, in its March 29, 2000 order on rehearing of its order accepting NYISO's market monitoring compliance filing subject to modifications,[9] the Commission specifically required NYISO to revises its mitigation plan to clarify that mitigation for market power is prospective only.

The Obligation to Support a Section 205 Filing

As mentioned above, among the reasons the Commission provided in the May 31 Order for denying NYISO's proposal to modify rates for any period prior to the filing of its section 205 filing was that given the Commission's finding of concentration as well as other market flaws in the operation of NYISO's markets, it would be very difficult for the New York ISO, or any party, to simply recalculate the correct market-based rates.

In its request for rehearing of the May 31 Order, NYISO for the first time proposed that any supplier of 10-minute NSR that was selected during the prior period but whose bidding behavior during that period "deviated significantly" from its bidding behavior before that period be paid $2.52. Other suppliers would be paid at the level of their actual bids, even if higher than $2.52. In addition, SR payments that were skewed upward by the artificially high 10-minute NSR prices would be reset to the highest offer from units providing SR, but no further adjustment for lost opportunity costs would be made. NYISO attached to its rehearing request an affidavit by its Market Advisor indicating that he has reviewed this methodology and considers it to be a reasonable approach to determining just and reasonable rates for operating reserves during the prior period.

[9] 90 FERC ¶ 61,317 at 62,055 (2000).

In the November 2001 Order, the Commission rejected NYISO's proposal that NSR suppliers that "deviated significantly" from their prior bidding behavior be paid $2.52. The Commission explained that NYISO failed to include this proposal in its prior filing, and that absent compelling reasons demonstrated by the petitioner, the Commission, as a general matter, will not entertain issues raised for the first time on rehearing which could have been raised earlier.

On rehearing of the November 2001 Order, NYISO asserts that its proposed methodology for determining just and reasonable rates was not a new issue, but a direct response to the explicit grounds advanced by the Commission for rejecting NYISO's request that its reserves rates be revised for the pre-March 28 period. NYISO asserts that it had no obligation in its initial tariff filing to identify a specific method for determining just and reasonable rates for this period, and instead could propose, as it did, that this issue be considered by the affected parties in the first instance through the ADR process.

The Commission rejects this argument. An applicant making a section 205 filing has an obligation in that filing to specify what revised rates it is seeking, or at least specify the computational method by which the rates would be determined. Section 35.1 of the Commission's regulations requires submittals to clearly and specifically set forth rates and charges. In any event, it is not enough to establish a procedural process to develop a rate methodology which is just and reasonable, and to calculate specific rates resulting from that methodology. In the circumstances of this case, the Commission was on solid ground in viewing NYISO's proffer of evidence in its rehearing request as injecting a new issue for the first time on rehearing, and in rejecting NYISO's request on that ground.

KeySpan's Request for Rehearing

As mentioned above, the May 31 Order allowed NYISO's proposed bid cap on NSR to become effective on March 28, 2000, the day after NYISO made its section 205 filing. In that order, the Commission also determined that NSR suppliers are entitled to payments for lost opportunity costs similar to what SR suppliers receive. In the November 2000 Order, the Commission determined that under Western Resources Inc. v. FERC (Western Resources),[10] the Commission did not have authority to permit the tariff sheets reflecting lost opportunity costs for NSR to become effective prior to the date of issuances of its order directing the change under section 206, May 31, 2000.

[10] 9 F.3d 1568 (D.C. Cir. 1993).

On rehearing of the November 2000 Order, KeySpan argues that Potomac Electric Power Co., et al. (Potomac Electric)[11] requires that the Commission make the lost opportunity cost provision effective March 28, 2000.[12] In that order accepting compliance filings required by an earlier order that accepted a PJM restructuring filing, the Commission ordered that specific changes it required to the existing wholesale power agreements and bilateral contracts so that a customer was not assessed multiple transmission charges be made effective the date of the PJM restructuring and PJM tariff. In distinguishing Electrical District No. 1, et al., v. FERC,[13] the Commission stated that to pick a different, later effective date for the compliance filings at issue would allow the PJM restructuring and PJM transmission tariff to become effective on April 1, 1998, while the related necessary changes in existing agreements, including the elimination of multiple transmission charges, would not become effective until later. This, the Commission concluded, would leave transmission owners like PSE&G in a better position than other transmission owners. KeySpan argues that like the elimination of multiple transmission charges in Potomac Electric, the provision concerning lost opportunity costs in this case is a "related necessary change" that should become effective on the same date that the bid cap was allowed to become effective.

Citing Northwest Pipeline Corp. (Northwest),[14] Williston Basin Interstate Pipeline (Williston),[15] Natural Gas Pipeline Co. Of America v. FERC (Natural),[16] KeySpan further argues that in requiring that the bid cap account for lost opportunity costs, the Commission was acting under section 205 and not section 206, and that Western Resources is distinguishable, because in this case the modification for lost opportunity

---

[11]83 FERC ¶ 61,162 (1998).

[12]KeySpan also notes that in Ordering Paragraph A of the May 31 Order, the Commission stated that "NYISO's March 27, 2000 filing, as modified above, is hereby accepted for filing to become effective on March 28, 2000, . . .", but that in November 2000 Order, the Commission determined that the effective date of the NSR lost opportunity cost provision should be May 31, 2000. Keyspan's concern in this regard is moot since this order grants Keyspan's request for rehearing on other grounds.

[13]774 F.2d 490, 492-95 (D.C. Cir. 1985).

[14]87 FERC ¶ 61,266 (1999).

[15]87 FERC ¶ 61,264 (1999).

[16]904 F.2d 1469, 1472 (10th Cir. 1990).

costs was a minor but integral change to the bid cap scheme. KeySpan maintains that the lost opportunity cost payment is integral because without it NSR suppliers would not be made whole for their lost opportunity costs and unjust and unreasonable rates would be in effect. In addition, KeySpan asserts that the Commission cannot sanction the bid cap for the March 28-May 31 period without the lost opportunity cost provision as a just and reasonable rate since no filed rate was accepted by the Commission until the May 31 Order.

Upon reconsideration, the Commission will grant rehearing on this issue and allow the lost opportunity cost provision to become effective on March 28, the same date as the NSR bid cap. The Commission agrees with KeySpan that as in Potomac Electric, the lost opportunity cost provision is a "related necessary change" that must be incorporated into the bid cap. Western Resources does not require a different result because there the Court acknowledged that "minor deviations from the pipeline's proposed rate based, for example, upon differences as to the extent of specific cost items, may be handled in a section 4 proceeding. . ."[17] Although the basic rate in question in this case is a market-based rate rather than a cost of service rate, the lost opportunity costs at issue here resemble a specific item of a cost of service rate in that they are identifiable costs which establish the rate if non-spinning reserves are not called upon. In any event, lost opportunity costs are "minor deviations" from the proposed rate in terms of methodology. Nor did the Commission rely on a "completely different strategy"[18] in formulating the just and reasonable rate. Rather, it adopted the applicant's basic strategy, i.e., the need for a bid cap, and made only a minor revision to that "strategy" by incorporating the lost opportunity cost provision.

In the November 2000 Order, the Commission attempted to ensure consistency with Western Resources by holding that the lost opportunity cost provision for NSR could become effective only prospectively from the date of the May 31 Order. However, upon further review, it does not appear that Western Resources allows the Commission to accept the basic NSR bid cap under section 205 as of the date of the filing, but separately in the same order make changes to that rate under section 206, to be effective as of the date of that order. Such an approach suggests that the Commission could, in the same order, find one rate, the bid cap without the lost opportunity cost provision, to be just and reasonable for an initial period, and then find a different rate, the bid cap with the provision, to be just and reasonable for a subsequent period. This approach has a certain

---

[17]Western Resources, 9 F.3d, at 1579. Section 4 is the Natural Gas Act (NGA) equivalent to section 205 of the FPA.

[18]Id.

appeal in that it may appear reasonable to assume that the FPA should be construed so that a proposed rate which is not perfect but which is much closer to the rate ultimately found by the Commission to be just and reasonable, may be accepted for the interim period between the filing of the rate and the Commission's decision, in place of a dramatically defective rate, such as the uncapped bid rate in the seriously flawed NSR market previously existing in this case. However, this suggests that in the same order the subsequent rates could somehow be determined more just and reasonable or that the initial period rates could be found to be only provisionally just and reasonable. There is nothing in Western Resources or other precedent to support such determinations.

Of course, there is a difficulty in mechanically applying Western Resources and other NGA section 4 and 5 precedent and FPA section 205 and 206 precedent to this NYISO case since this case does not present the usual NGA section 4 or FPA section 205 situation where a utility proposes a rate increase and its customers object. Rather, here the regulated entity, NYISO, proposes a rate decrease under section 205, and the market participants who object are suppliers to the NYISO market. Yet there are obvious parallels between the NGA and FPA precedent and this case and, in any event, sections 205 and 206 remain the governing statutory provisions.

The Commission's decision here is also consistent with two gas pipeline certificate cases, Transcontinental Gas Pipe Line Corporation v. FERC (Transco),[19] and Texas Eastern Transmission Corporation v. FERC (Texas Eastern).[20] In the Transco case, the Court remanded Commission orders granting the pipeline certificate authority to provide additional natural gas transportation service to existing customers. The initial order held that the pipeline should use modified fixed-variable (MFV) rates rather than the straight fixed-variable (SFV) rates proposed by the pipeline. The second order found that SFV rates should be charged, but that such rates should become effective only a year after commencement of the service, and that the MFV rates should remain in effect from the commencement of service until that time. Because there might be some legitimate reason for the Commission to apply MFV rather than SFV rate design for all or part of the initial year of service, although the Commission had yet to articulate such a reason, the Court remanded the case rather than require a commencement of service effective date for SFV.

There are two important differences between Transco and the instant NYISO case which prevent rigid application of Transco to this case. First, Transco involved an initial rate filed pursuant to section 7 of the NGA, which has no FPA equivalent, so that unlike

---

[19]54 F.3d 893 (D.C. Cir. 1995).

[20]102 F.3d 174 (5th Cir. 1996).

this case, which was filed under section 205, there was no existing just and reasonable rate that had to be found unjust and unreasonable before a substitute rate could be approved. Second, Transco involved "dueling rates", SFV versus MFV, which were in question from the time Transco filed its certificate application until the second Commission order found SFV appropriate. In contrast, in this case, all of the Commission orders in question found the bid cap plus opportunity cost provision preferable to the simple bid cap proposed by NYISO. The only question here is the effective date of the lost opportunity cost provision given that the Commission first addressed NYISO's filing in the May 31 Order, some two months after NYISO's filing. However, insofar as Transco may be read to attach weight in NGA section 4, 5, and 7 proceedings (and FPA section 205 and 206 proceedings) to such policy considerations as the customers' expectations, it supports a finding that the effective date of the lost opportunity costs provision here should be no later than at least the date of the filing of the generators' protests requesting that the provision be added. No record has been compiled in this case concerning the question of whether NYISO's customers had even earlier effective notice, through NYISO's internal committee processes or otherwise, that the lost opportunity costs provision would be an issue in this proceeding that would support, on a customer expectations rationale, an earlier effective date.

In Texas Eastern, the Court upheld the Commission's determination in its initial order that the rates should be based on MFV, rather than the SFV rate design proposed by the pipeline, because the pipeline had not requested rehearing of the initial order so that the rates required there had become final and could not be modified retroactively even though the Commission ultimately adopted SFV (to be effective prospectively). The Court held that in these circumstances, the Commission's decision to invoke the filed rate doctrine in a NGA section 7 proceeding was reasonable. However, the instant NYISO case is distinguishable since here there was a timely request for rehearing concerning the effective date of the lost opportunity cost provision, which kept the initial effective date of that provision in question and made possible retroactive application of the provision to the date of NYISO's filing.

The Commission orders:

NYISO's request for rehearing of the November 2001 Order is denied, and KeySpan's request for rehearing concerning the November 2000 Order is granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.