UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Market-Based Rates for Wholesale
Sales of Electric Energy,
Capacity and Ancillary Services — Docket No. RM04-7-000

REQUEST FOR REHEARING OF
THE NATIONAL ASSOCIATION OF
STATE UTILITY CONSUMER ADVOCATES

I. Introduction

The Federal Energy Regulatory Commission ("FERC" or "Commission") on May 19, 2006 issued a Notice proposing to adopt new regulations relating to market-based rates for wholesale sales of electric energy, capacity and ancillary services. *Notice of Proposed Rulemaking*, Docket No. RM04-7-000 (May 19, 2006) ("*Notice"*). In the *Notice*, FERC proposed to codify, and modify, its policies regarding market-based rates previously contained in prior Commission orders, and to "streamline" utility filing requirements.[1] The Commission also proposed to modify all existing market-based rate authorizations and tariffs to reflect new regulatory requirements.

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[1] The *Notice* stated the Commission is "proposing to codify, and in certain respects, revise its current standards for granting market-based rates for sales of electric energy, capacity, and ancillary services. The Commission is proposing to retain several of the core elements of its current standards for granting market-based rates. However, we propose certain revisions to these standards and seek comment on other issues. The Commission also proposes to streamline certain aspects of its filing requirements to reduce the administrative burdens on applicants, customers and the Commission." *Notice* p. 1. The *Notice* is available at http://www.ferc.gov/whats-new/comm-meet/051806/E-2.pdf .

The National Association of State Utility Consumer Advocates ("NASUCA")[2] participated actively in the proceeding, filing *Initial Comments*[3] on August 7, 2006 and *Reply Comments*[4] on September 20, 2006. On June 21, 2007 the Commission issued *Order 697*, adopting a *Final Rule*[5] which modifies and adopts the actions proposed in the *Notice.* NASUCA now requests rehearing.

STATEMENT OF ISSUES FOR REHEARING
AND REPRESENTATIVE PRECEDENT

I. **THE COMMISSION MUST INVESTIGATE WHETHER SELLERS ARE ABLE TO RAISE ELECTRICITY AUCTION MARKET RATES TO HIGHER, NON COMPETITIVE LEVELS, WITHOUT COLLUSION, THROUGH STRATEGIC BIDDING AND GAMING BEHAVIOR**

A. Experience, mathematical game theory analysis, judicial decisions, and laboratory simulations indicate that market participants who pass market power screens nonetheless may be able to elevate prices in FERC-approved auction markets through non collusive strategic bidding, withholding, and gaming tactics.

B. The Commission found that consideration and analysis of such behavior would be burdensome. *Final Rule* 124,

C. The "primary purpose" of the Federal Power Act and FERC is protection of utility consumers. *Electrical Dist. No. 1, et al., v. FERC*, 774 F.2d 490, 492-493 (D.C. Cir. 1984). To achieve confidence that rates set in its markets are reasonable, FERC must investigate strategic bidding and market gaming. At a minimum, FERC should invite researchers who have identified strategic auction market

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[2] NASUCA is an association representing 45 state utility The Commission should not rely on a state's adoption of a retail access regime for any determination that a customer is not captive.
consumer advocate offices in 42 states and the District of Columbia.

[3] NASUCA *Initial Comments*, August 7, 2006, available at http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=11111324

[4] NASUCA *Reply Comments*, September 20, 2006, available at http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=11137814

[5] The *Final Rule* is available at http://www.ferc.gov/whats-new/comm-meet/2007/062107/E-1.pdf

gaming as a problem in auction markets of the type used for the sale of electricity to present their research at a public technical conference.

II. IN CALCULATING MARKET SHARE WHEN SCREENING FOR HORIZONTAL MARKET POWER, THE COMMISSION SHOULD NOT SUBTRACT CAPACITY NEEDED FOR LONG TERM CONTRACTS AS "COMMITTED" IF THE CONTRACTS ARE INDEXED OR LINKED TO SPOT MARKET PRICES

A. Market rate authorizations are predicated upon a Commission finding that the seller lacks market power, using "screens" including a measure whether a seller's share of "uncommitted" capacity in a relevant market exceeds 20%. *Final Rule,* ¶ 13.

B. A seller with a market share of capacity greater than 20% can reduce it, and pass a market power screen it would otherwise fail, by "committing" portions of its capacity. "When calculating uncommitted capacity for the market share screen, a seller deducts from its total capacity the capacity dedicated to long-term sales contracts...." *Final Rule*, ¶ 90

C. NASUCA requested the Commission to clarify that it will not consider capacity dedicated to meeting long term contract sales of energy to be "committed" - and thus disregarded from market share – if the price of energy in the long term contracts is indexed or linked to spot market prices. NASUCA *Initial Comments*, 16.

D. The Commission apparently overlooked and did not rule on NASUCA's request. *Final Rule,* ¶¶ 82 - 93. The Commission should grant NASUCA's request because research indicates that long term contracts linked to spot market prices do not reduce, and may exacerbate, the ability of a seller to raise spot market prices above competitive levels.

III. SELLERS WITH MARKET POWER SHOULD NOT BE ALLOWED TO DETERMINE AND CHANGE THEIR RATES WITHOUT COMPLYING WITH FPA SECTION 205 FILING REQUIREMENTS

A. The Commission allows sellers with market-based rates to implement new rates and charges subject only to quarterly retrospective reports, if they are deemed not to have market power, thus dispensing with prior filing of rate changes and revised charges as specified in FPA § 205.

B. The *Final Rule* allows sellers <u>with</u> market power to dispense with the filing of changes in rates for periods of one year, within the range of default mitigation rates. There is no evidence to support a finding that rates of marginal cost plus 10% are reasonble, *NSTAR Electric & Gas Corp. v. FERC*, 481 F.3d 794 (D.C. Cir. March 9, 2007) or that rates between marginal cost and embedded cost are always reasonable. *FPC v. Conway Corp*., 426 U.S. 271 (1976). A consequence is that there is no possibility of public notice, protest, FERC review prior to imposition of unreasonable new charges, and no opportunity for refund of unreasonable rates charged by sellers with acknowledged market power.

C. FPA Section 205(d) requires that all rate increases and other changes in rates or charges must be filed 60 days in advance of being charged, unless FERC for good cause shown issues an order “specifying the changes” to be made, and specifying “the time when the change or changes will go into effect.” 16 U.S.C. 824d(d).

D. The Final Rule responded to NASUCA’s concerns by saying that rate “proposals” of mitigated sellers would be filed. FERC did not modify the regulation which specifies that only new contracts of a duration of more than one year will be filed. FERC should clarify that mitigated sellers must file not only “proposals” for sales agreements for less than one year, but the actual contracts and schedules of rates to be charged must also be filed..

IV. THE EXEMPTION FROM MARKET POWER REVIEW OF SELLERS WHO OWN OR CONTROL GENERATION OF 500MW OR LESS LACKS JUSTIFICATION

A For sellers of electricity from the power plants with less than 500 MW capacity who are now exempt from any market power test, the “prevailing price in the marketplace” is indeed the “final measure” of the rates being demanded, changed and charged - a result contrary to the intent of Congress ascertained by the Supreme Court in *FPC v. Texaco*, 417 U.S. 380, 397 (1974)

B. It cannot be presumed that the market prices demanded by all Category 1 sellers will be “competitive” or reasonable.

C. If the Commission desires to identify a threshold below which a seller cannot exercise market power, it should commence a new proceeding to develop an evidence-based standard.

V. THE COMMISSION HAS NOT ARTICULATED AN ADEQUATE LEGAL BASIS TO SUPPORT THE *FINAL RULE’ S* REDUCED MARKET POWER REVIEW AND FILING REQUIREMENTS

REQUEST FOR REHEARING

I

THE COMMISSION MUST INVESTIGATE WHETHER SELLERS ARE ABLE TO RAISE ELECTRICITY AUCTION MARKET RATES TO UNREASONABLE LEVELS, WITHOUT COLLUSION, THROUGH STRATEGIC BIDDING AND GAMING BEHAVIOR

NASUCA's *Initial Comments* cited mathematical game theory analysis, judicial decisions, and laboratory simulations which indicate that market participants who pass market power screens nonetheless may be able to elevate prices in FERC-approved auction markets through non collusive strategic bidding, withholding, and gaming tactics. *See, e.g.,* Kovenock, *Tacit Collusion and Capacity Withholding in Repeated Uniform Price Auctions*, Purdue (2004);[6] Rudkevich, A.; Duckworth, M.; Rosen, R., Modeling Electricity Pricing in a Deregulated Generation Industry: The Potential Oligopoly Pricing in a Poolco, The Energy Journal, Vol. 19, No. 3 (1998);[7] T.D. Mount, W.D. Schulze, R.J. Thomas, R.D. Zimmerman, "*Testing the Performance of Uniform Price and Discriminative Auctions*," Cornell University Dept. of Applied Economics and Management and Dept. of Electrical and Computer Engineering (July 16, 2001).[8]

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[6] *Available at* http://scholar.google.com/url?sa=U&q=http://www.iui.se/wp/wp636/IUIWP636.pdf .

[7] "Our principal findings are that generating firms can exercise market power in such markets by adopting mutually profit-maximizing, stable bidding strategies, consistent with the Nash Equilibrium, that lead to average prices considerably higher than those expected from production cost bidding. Our findings have strong policy implications for the deregulation of electricity markets across the U.S., and suggest that current DOJ and FERC guidelines may not be adequate in countering the exercise of market power in bid-based power pools. The analysis of market power in poolco markets should, to the extent possible, be extended to include simulation modeling of the various bidding strategies that could be adopted by generating firms to influence market clearing prices."

[8] *Available at* http://www.pulp.tc/uniformprice.pdf .

Despite these demonstrations, FERC's market power screens are based on static analyisis of single sellers' market shares. Less than a 20% share of the relevant market capacity is sufficient, and less than the supply margin on the annual peak day satisfies the "supply margin assessment." Neither of these tools addresses the problem identified in the research, that sellers in these specialized markets repeatedly communicate through their bidding behavior. Through this repetitive interaction, they can learn to raise prices to mutual benefit, well above competitive levels, without overt collusion or conspiracy.

Also, a news story subsequent to issuance of comments informed the general public that "organized markets" whose design has been approved by FERC can be readily gamed by non expert participants simply using the results of a computer program algorithm developed through mathematical game theory analysis.[9] To our knowledge, the Commission has never publicly discussed this in depth in its orders, has not investigated the problem, has held no technical conference or workshop to invite researchers to present their findings regarding gameability of the wholesale electricity markets.

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[9] "[C]ritics of the current system have found ammunition in a study at Carnegie Mellon University by Sarosh N. Talukdar, who used computer models to simulate a market in which 10 utilities bought electricity and 10 producers sold it. In that experiment, the buyers and sellers learned to manipulate the price within 100 rounds of bidding, capturing from 50 percent to 90 percent of the prices an unregulated monopoly would have charged. Instead of falling, prices soared.

Earlier experiments at Cornell University and George Mason University found the same thing, with simulated trading by students, professors and even members of Congress.

Such high prices suggest collusion, which is illegal in real markets, but collusion was impossible in Professor Talukdar's experiments because the trades were made by simple computer programs, not humans. "*My studies show it is easy to learn from the signals given by others how to get the benefits of colluding without breaking the law*," Professor Talukdar said.

"Economists have this faith in markets, this blind faith that markets are always a good thing," the professor said, "but the design of markets matters a great deal and the design must be verified to see if it really works as a free market." David K. Johnston, *Flaws Seen In Markets For Utilities* N.Y. Times, November 21, 2006 (*Emphasis added)*, *available at* http://select.nytimes.com/search/restricted/article?res=F00717FF395A0C728EDDA80994DE404482

The NASUCA comments requested investigation of market gaming potential by market participants who have passed FERC's existing market power screens. *Final Rule*, 121, 124. NASUCA's comments urged that strategic market behavior analysis is needed to assess whether current market designs allow participants, without overt collusion, to elevate market prices to unreasonable and non competitive levels. The purpose of such analyses would be to take corrective action to prevent gaming behavior, by revising market designs or rules. Apparently misunderstanding NASUCA's request, the Commission found that consideration and analysis of such behavior would be burdensome and impractical. *Final Rule* 124.

The "primary purpose" of the Federal Power Act and FERC is protection of utility consumers. *Electrical Dist. No. 1, et al., v. FERC*, 774 F.2d 490, 492-493 (D.C. Cir. 1984). To achieve confidence that rates set in FERC sanctioned markets are reasonable, FERC must investigate strategic bidding and market gaming by market participants. At a minimum, FERC should commence a proceeding to investigate this and begin it by inviting researchers who have identified strategic auction market gaming as a problem in auction markets of the type used for the sale of electricity to present their research at a public technical conference.

II

IN CALCULATING MARKET SHARE WHEN SCREENING FOR HORIZONTAL MARKET POWER, THE COMMISSION SHOULD NOT SUBTRACT CAPACITY NEEDED FOR LONG TERM CONTRACTS AS "COMMITTED" IF THE CONTRACTS ARE INDEXED OR LINKED TO SPOT MARKET PRICES

Market rate authorizations are predicated upon a Commission finding that the seller lacks market power, using"screens" including a measure whether a seller's share of "uncommitted" capacity in a relevant market exceeds 20%. *Final Rule*, ¶ 13. A seller with a market share of capacity greater than 20% can reduce it, and pass a market power screen it would otherwise fail, by "committing" portions of its capacity. "When calculating uncommitted capacity for the market share screen, a seller deducts from its total capacity the capacity dedicated to long-term sales contracts...." *Final Rule*, ¶ 90.

NASUCA requested the Commission to clarify that it will not consider capacity dedicated to meeting long term contract sales of energy to be "committed" - and thus disregarded from market share – if the price of energy in those long term contracts is indexed or linked to spot market prices. NASUCA *Initial Comments*, 16. NASUCA identified relevant research in support if its request.[10]

The Commission apparently overlooked NASUCA's request and did not rule on it. *Final Rule,* 82 - 93. The Commission should grant NASUCA's request, or, alternatively, conduct further proceedings to examine the exercise of market power by sellers who pass market screens due to their contract commitment to make long term energy sales at rates indexed to spot market prices.

III

SELLERS WITH MARKET POWER SHOULD NOT BE ALLOWED TO DETERMINE AND CHANGE THEIR RATES WITHOUT COMPLYING WITH FPA FILING REQUIREMENTS

The Commission allows sellers with market-based rates to implement new rates and charges subject only to quarterly retrospective reports, if they are deemed not to have market

[10] Chloé Le Coq. *Index Contracts and Spot Market Competition*, University of California Energy Institute, Center for the Study of Energy Markets, June 2006, p. 15, *available at* http://www.ucei.berkeley.edu/ThirdTierButtons/PDFButton_Off.jpg

power, thus dispensing with prior filing of rate changes and revised charges as specified in FPA § 205. Sellers with market power have, until now, been required to file cost-based rates.

The *Final Rule* allows sellers with market power to dispense with the filing of contracts and changes in rates, within the range of default mitigation rates, which vary by duration of the sale.[11] Only contracts for sales greater than one year would be filed under Section 205. A consequence is that there is no possibility of public notice, protest, FERC review prior to imposition of unreasonable new charges, and no opportunity for refund of unreasonable rates charged by sellers with market power for sales of up to one year's duration.

NASUCA pointed out that allowing a seller with market power to set rates at will between marginal cost and embedded cost may not be reasonable and could allow discrimination, Even though looked at separately, the incremental cost base rate and the embedded cost rate could be within the zone of reasonableness, giving the utility the option to pick its rates and its customers in bilateral transactions could give the utility with wholesale market power the opportunity to extend it into retail markets, favoring its retail affiliate, for example. See *FPC v. Conway Corp*., 426 U.S. 271 (1976). In *Conway*, the Supreme Court held that a utility could not set low retail rates to attract retail industrial customers from other utilities and set wholesale rates at prices higher than the retail rate so that its wholesale competitors could not compete in the

[11] New regulation §35.38 provides: "(b) Default mitigation consists of three distinct products: (1) Sales of power of one week or less priced at the Seller's incremental cost plus a 10 percent adder; (2) Sales of power of more than one week but less than one year priced at no higher than a cost-based ceiling reflecting the costs of the unit(s) expected to provide the service; and (3) New contracts filed for review under section 205 of the Federal Power Act for sales of power for one year or more priced at a rate not to exceed embedded cost of service."

retail market. The Supreme Court also rejected the Commission's argument that it could not consider the impact of the wholesale rates on the retail market.

Accordingly, the Commission should not allow this potentially discriminatory and predatory conduct in the name of granting "flexibility" to utilities. The protection for consumers and competitors is for the utilities with market power to file cost based rates subject to the public notice and review procedures of Section 205.

Allowing sellers with market power to make sales for less than one year without filing them is a subdelegation to private parties of basic duties conferred upon FERC by Congress. See *U.S. Telecom Ass'n v. FCC*, 359 F. 3d 554, 567 - 78 (D.C. Cir. 2004). As stated by Chairman Kelliher, in a case involving waiver of the advance rate filing requirement of FPA § 205 for rates negotiated among utilities but not timely filed with the Commission, allowing utilities to establish new rates without filing them is impermissible subdelegation of FERC's duties under the FPA:

> I disagree with the Commission's decision to deny rehearing of an earlier order that accepted for filing three mitigation agreements and to grant waiver of the 60-day prior notice requirement.
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> In my view, Market Rule 17 was an improper delegation of the Commission's ratemaking authority to ISO-NE. *Section 205 of the FPA vests exclusive authority with the Commission to set the rates and charges for wholesale electric sales of energy*.[] In doing so, the Commission must determine that the rates and charges approved are just and reasonable. Under *U.S. Telecomm.Ass'n v. FCC*, [] federal agencies such as the Commission cannot delegate their authority to outside entities--private or sovereign– absent an affirmative showing of congressional authorization.[] The FPA contains no provision authorizing the Commission to delegate its ratemaking authority. Since ISO-NE is an outside party, the Commission cannot lawfully delegate its ratemaking authority to the ISO.
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> In this instance, the Commission accepts mitigation agreements the ISO-NE

> negotiated and entered into pursuant to Market Rule 17, even though the Commission never reviewed the agreements to determine that they are just and reasonable. In these circumstances, I believe the conclusion is inescapable that by authorizing the ISO-NE to enter into mitigation agreements that were not reviewed by the Commission and found to be just and reasonable, the Commission improperly delegated its authority under section 205 of the FPA.[12]

In this case, the *Final Rule* essentially has the same defect identified above by Chairman Kelliher: Rates of sellers with market power, when they involve sales for less than one year, are allowed to take effect without observing prior filing requirements, with FERC relying on private parties to negotiate and charge reasonable rates. There is, however, no provision in the statute granting FERC the power to direct utilities not to file their rates for sales of less than one year. See *MCI Telecommunications Corp. v. American Telephone & Telegraph Co.*, 512 U.S. 218, 229 -230 (1994) (FCC lacked power to eliminate filing requirement for sellers deemed to lack dominant market power).[13]

After comments were submitted, the Court of Appeals for the District of Columbia rejected rates that had been charged by utility negotiation at marginal cost plus 10% without being timely filed for possible review and revision by FERC for lack of evidence. The same flaw applies here to the generic rate ranges approved for sellers with market power. There is no evidence that such rates are reasonable.

The *Final Rule* responded to NASUCA's concerns by saying that rate "proposals" of mitigated sellers would be filed. The *Final Rule* does not say *rates, rate schedules, and*

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[12] *ISO New England Inc.*, FERC Docket No. ER03-631-002 *Order Denying Rehearing and Clarification, and Granting Waiver* (Issued July 11, 2005), *Dissenting Opinion.* The order was reversed on other grounds in *NSTAR Electric & Gas Corp. v. FERC*, 481 F.3d 794 (D.C. Cir. March 9, 2007).

[13] *Accord, American Telephone & Telegraph Co. v. Central Office Telephone, Inc.* 524 U.S. 214 (1998) (citing cases involving similar filing provisions of the Natural Gas Act and the Interstate Commerce Act).

contracts will be filed, and it adopts the rule which clearly states that only new contracts of a duration longer than one year are to be filed under Section 205. *Final Rule,* § 35.38 As stated by the Court of Appeals in analogous circumstances, where actual changes in rates and charges had not been filed, "FERC's new policy of making rates effective as of the date of an order setting forth no more than the basic principles pursuant to which the new rates are to be calculated would make unforeseeable liabilities a regular consequence of rate adjustments . . . ." *Electrical Dist. No. 1, et al., v. FERC*, 774 F.2d 490, 492-493 (D.C. Cir. 1984). FERC should clarify that sellers with market power must file not only "proposals" but schedules containing their actual rates and contracts, before the charges are implemented, in accordance with FPA Section 205.

IV

THE EXEMPTION FROM MARKET POWER REVIEW OF SELLERS WHO OWN OR CONTROL GENERATION OF 500MW OR LESS LACKS JUSTIFICATION

The *Final Rule* exempts from market power assessment those who own or control generation capacity of 500 MW or less. The new rule exempting these "Category 1" sellers from review for market power lacks factual and legal justification.

In its *Initial Comments,* NASUCA identified the inconsistency of this approach with the justifications previously given to the courts, *viz.*, that the Commission carefully assesses the market power of any entity allowed to sell at market rates. The Commission's rationale for excusing sellers with market-based rates from the FPA Section 205 requirements is predicated upon a prior Commission review of evidence and a determination that each seller seeking market-based rate authorization lacks market power, coupled with review of *post hoc* quarterly reports of rates actually charged. As stated by the Ninth Circuit:

> FERC's system consists of a finding that the applicant lacks market power (or has taken sufficient steps to mitigate market power), coupled with strict reporting requirements to ensure that the rate is "just and reasonable" and that markets are not subject to manipulation. Here, FERC required the wholesale seller to file a market analysis every four months, and quarterly reports summarizing its transactions during the preceding three months. These transaction summaries include both long and short-term contracts, purportedly with reports of some sales for intervals as small as ten minutes. *FERC has affirmed in its presentation before us that it is not contending that approval of a market-based tariff based on market forces alone would comply with the FPA or the filed rate doctrine.*

Lockyer v. FERC, 383 F.3d 1006 (9th. Cir. 2004), *cert. denied* __ *U.S.* __ *2007* (*emphasis added)*. The Ninth Circuit mistakenly believed that the market power assessment under current FERC orders is made tri*a*nnually (*i.e.*, once every four months) when was only required tri*ennually* (i.e., once every three years). Because the *Final Rule* would completely eliminate the triennial review for many sellers in the proposed Category 1 with less than 500 MW, the basis for the decision in Lockyer, *supra*, to the extent it is based on the Court's belief that FERC reviews market power of all sellers four times a year, is very seriously undermined. The blanket exemption from market power review of all sellers owning or controlling less than 500 MW capacity is utterly inconsistent with the Commission's stated rationale for allowing a market-based rate system. *Lockyer v. FERC*, *supra.*

In addition, the Commission appears to have reversed the burden previously placed on applicants for the "privilege" of market-based rates. Discussing the transition to the new rules, the Commission states "While it is true that a portion of these sellers will continue to sell at market-based rates for a time until their updated market power analyses (in the case of Category

2 sellers) or their filings addressing qualification as Category 1 sellers are due, *no commenter has submitted compelling evidence that Category 1 sellers have unmitigated market power*." *Final Rule*, ¶ 334. This reverses the customary burden of proof borne by applicants for a benefit. *Schaffer v. Weast*, 546 U.S. (2005). "Where the burden of proof lies on a given issue is, of course, rarely without consequence and frequently may be dispositive to the outcome of the litigation or application." *Lavine v. Milne*, 424 U. S. 577, 585 (1976). The *Final Rule* essentially granted all Category 1 sellers market rates without their applying and demonstrating a lack of market power, and required objectors to submit "compelling evidence" in a non evidentiary proceeding.

It cannot be presumed that the market price demanded by all Category 1 sellers will be a "competitive" price, or more relevantly, a "just and reasonable" rate, the latter being the standard that must be met under section 205 of the FPA. In a discussion of this subject -- whether the Commission can rely solely on market prices to produce the "just and reasonable" rates required by statute -- the Supreme Court rejected any conflation of a "competitive" market price with the "just and reasonable" rate required by statute, stating:

> For the purposes of the proceedings that may occur on remand, <u>we should also stress that in our view the prevailing price in the marketplace cannot be the final measure of "just and reasonable" rates mandated by the Act</u>. * * * * <u>Congress could not have assumed that "just and reasonable" rates could conclusively be determined by reference to market price</u>. * * * * This does not mean that the market price of gas would never, in an individual case, coincide with just and reasonable rates or not be a relevant consideration in the setting of area rates, see Permian Basin Area Rate Cases, 390 U.S., at 793 -795; it may certainly be taken into account along with other factors, Southern Louisiana Area Rate Cases, 428 F.2d 407, 441 (CA5), cert. denied sub nom. Associated Gas Distributors v. Austral Oil Co., 400 U.S. 950 (1970). <u>It does require, however, the conclusion that Congress rejected the identity between the "true" [just and reasonable] and the "actual" market price</u>.

FPC v. Texaco, 417 U.S. 380, 397 (1974) (*emphasis added).* For sellers of electricity from the power plants with less than 500 MW capacity who are now exempt from any market power test, the "prevailing price in the marketplace" is indeed the "final measure" of the rates being demanded, changed and charged - a result contrary to the intent of Congress ascertained by the Supreme Court in *FPC v. Texaco, supra*.[14] Any action based on subsequent quarterly reports would, at best, result in prospective changes in rates, assuming that the rates are still in effect when the reports are made.

There is no basis in the record of this proceeding to assume that power marketers or producers who own or control less than 500 MW of generation lack market power at all times. It is not difficult to conceive of situations, for example, in load pockets or other transmission constrained areas, where sellers with less than 500 MW of capacity could exercise market power, either alone or acting strategically without overt collusion to inflate rates when supply margins are tight. These sellers might at times have considerable market power with respect to ancillary services, such as voltage support, frequency response service, sales of capacity, and operating reserve service. Changing circumstances also may affect the opportunity of seemingly small sellers to exercise market power. For example, reserve margins may decline in some areas creating new opportunities for market power exercise.[15] Also, because the definition of seller

[14] Although *FPC v. Texaco, supra* considered provisions of the Natural Gas Act, the Federal Power Act provisions still in force today are similar, and precedents under those statutes are cited and followed interchangeably. "[T]the relevant provisions of the two statutes "are in all material respects substantially identical." *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956).

[15] As an example of how capacity reserves can shrink rapidly (and thereby increase substantially a seller's market share of the supply margin), a recent National Research Council report states: "The deteriorating outlook for reliability in the NYCA [New York Control Area] is best summarized by the drop in projected reserve margins for generating capacity from the forecast made in 2004 to that in 2005.

includes not only owners of generating plants but also power marketers, this loophole might encourage power marketers to control segments of power plants up to 499.9 MW and through strategic bidding or other methods exercise subtle market power in certain locations at certain times. As a result of this exemption, sales from these facilities will be at prices *solely* determined by market forces. This is a fatal flaw, and must be corrected.

If the Commission desires to identify a threshold below which a seller cannot exercise market power, it should commence a new proceeding, conduct technical workshops, gather evidence from the public and from RTO market monitors, and receive comments before adopting an evidence-based standard.

V

THE COMMISSION HAS NOT ARTICULATED AN ADEQUATE LEGAL BASIS TO SUPPORT THE *FINAL RULE' S* REDUCED MARKET POWER REVIEW AND FILING REQUIREMENTS

Citing concerns about reduced market power review and filing requirements, NASUCA pointed out in its *Initial Comments* that the *Notice* contained no section addressing the Commission's legal authority for the proposed action, and questioned whether legal authority for the proposed actions was sufficient. The Commission mentions this in the *Final Rule*I

> NASUCA similarly questions the Commission's reliance on *Elizabethtown Gas* as the legal foundation for its market-based rate regime. NASUCA suggests that the Supreme Court's decision in *MCI v. AT&T*, casts considerable doubt on the vitality of *Elizabethtown Gas* and cases that follow its apparent endorsement of market-based rates that did not consider the

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A year ago as of this writing, in 2004, the reserve margin in 2008 was expected to be over 40 percent; however, the 2005 projection for 2008 was less than the 18 percent needed to meet the NERC reliability standards...." *Alternatives to the Indian Point Energy Center for Meeting New York Electric Power Needs,* National Research Council (June 2006), *available at* http://www.nap.edu/catalog/11666.html .

> statutory filing issues found crucial in MCI. NASUCA also notes that, in another case the Commission relied on, *Mobil Oil Exploration v. United Distribution Co.*, the Supreme Court cited to *FPC v. Texaco*, where it held that just and reasonable rates cannot be determined solely by reference to market prices.

Final Rule, ¶ 939. The Commission responded to NASUCA's concerns, citing its power to modify filing requirements,[16] and relying on the decision of the Ninth Circuit in *California ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004), cert denied __ U.S. __ (2007):

> In Lockyer, the Ninth Circuit cited with approval the Commission's dual requirement of *an ex ante finding of the absence of market power and sufficient post-approval reporting requirements* and found that the Commission did not rely on market forces alone in approving market-based rate tariffs. The Ninth Circuit held that *this dual requirement was "the crucial difference"* between the Commission's regulatory scheme and the FCC's regulatory scheme, remanded in MCI, which had relied on market forces alone in approving market-based rate tariffs. * * * *
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> Accordingly, the Commission rejects the position of commenters arguing that the Commission lacks authority to continue to permit market-based rates for wholesale sales of electricity. The courts have sustained the Commission's finding that market-based rates are one method of setting just and reasonable rates under the FPA. As supplemented by this Final Rule, the Commission finds that the market-based rate program complies with the statutory and judicial standards for acceptable market-based rates. We will retain our policy of granting market-based rate authority to sellers without market power under the terms and conditions set forth in this Final Rule and the Commission's regulations.

Final Rule, ¶ 953 - 954. The "crucial difference" between impermissible exclusive reliance on market rates found in the *Lockyer* decision, however, is absent in the revisions made in the Final Rule. The Ninth Circuit (mistakenly) believed that FERC looks at a seller's market power

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[16] The Commission invokes FPA Section 205 (c) as authority for its power to adjust timing of rate filing. The adjacent statutory language of Section 205(d), however, limits that power:

> The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for *by an order specifying the changes so to be made and the time when they shall take effect* and the manner in which they shall be filed and published."

16 U.S.C. § 824d(d) (*Emphasis supplied).*

reviews in tri*annual* reviews, *i.e.,* conducted once every four months, rather than *triennial* reviews, *i.e.,* once every three years. Now, under the *Final Rule*, market power review is to be eliminated altogether for many sellers in the "Category 1" classification, with no specific review of those sellers' potential to exercise power. Also, there is no record in this case to support a generic "finding" why a seller with 499 MW capacity needs no market power review and a seller of 501MW does.

In light of the *Final Rule's* reduced requirements for market power review, the *post hoc* reporting requirement – now in many instances the only prong of the "dual" market rate review standard that will remain – is not sufficient to protect customers. The *Final Rule* fails to identify an objective standard by which to ascertain, after rates have been changed, charged, and eventually reported, whether a market rate is or is not in the zone of reasonableness. "[W]hile the Commission could take competition and market prices into account in its review, it cannot *exclusively* rely on markets." *NASUCA Initial Comments* at 34, *emphasis added* . The actions being taken to "streamline" filing requirements, eliminate market power reviews for many sellers, and to rely mainly on a *post hoc* monitoring process does not constitute the "bond" of protection required for consumers.

CONCLUSION

The Commission's policies and rules regarding market-based rates are having major impacts upon consumers and there is a heightened interest in seeing that the primary purpose of the Federal Power Act, the protection of consumers, is effectuated. The *Final Rule* overlooks vital consumer protection issues and further relaxes oversight in ways that are unsupported, as discussed above. NASUCA asks that its request for rehearing be granted, and that changes be made in response to the concerns identified above.

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Respectfully submitted,

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