

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

State of California, ex. rel. Bill Lockyer,)	
)	
Complainant,)	
)	
v.)	
)	
British Columbia Power Exchange Corp.,)	
Coral Power, LLC, Dynegy Power Marketing, Inc.,)	
Enron Power Marketing, Inc.,)	Docket No. EL02-71-000
Mirant Americas Energy Marketing, LP,)	
Reliant Energy Services, Inc.,)	
Williams Energy Marketing & Trading Co.,)	
)	
All Other Public Utility Sellers of Energy and)	
Ancillary Services to the California Energy Resources)	
Scheduling Division of the California Department)	
of Water Resources, and)	
)	
All Other Public Utility Sellers of Energy and)	
Ancillary Services into Markets Operated by the)	
California Power Exchange and)	
California Independent System Operator,)	
)	
Respondents.)	

**MOTION TO INTERVENE AND COMMENTS
OF THE ELECTRICITY CONSUMERS RESOURCE COUNCIL**

Pursuant to Rule 214 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission, 18 C.F.R. § 385.214, the Electricity Consumers Resource Council (“ELCON”) hereby requests leave to intervene in the Complaint filed in the above-captioned proceeding.

MOTION TO INTERVENE

ELCON is an association of industrial consumers of electricity organized to promote the development of coordinated and rational federal and state policies that will assure an adequate, reliable, and efficient electricity supply for all users at competitive rates. ELCON member companies represent virtually every segment of the manufacturing community. The member companies of ELCON consume approximately five percent of all electricity in the United States.

Several ELCON members are headquartered or have facilities located in California, and are major industrial consumers of power in the California energy markets. Accordingly, ELCON has a direct and substantial interest in the outcome of this proceeding that cannot be adequately represented by any other party.

BACKGROUND OF THE PROCEEDING

The California Attorney General (“Cal AG”) has filed a Complaint with FERC alleging that the Federal Power Act (“FPA”) requires that all rates be filed with FERC prior to their use. The Cal AG asserts that the use of market-based rates violates the FPA for two reasons. First, the rates are not filed prior to their use and FERC thus cannot predetermine that the rates are just and reasonable prior to their use. The Cal AG recognizes that FERC can approve formula rates, but asserts that market based rates are not formula rates. Second, the Cal AG points out that the FPA requires that all market-based transactions are supposed to be filed with FERC after the fact. However, the Complaint states that individual transactions are not now filed -- only quarterly reports summarizing the transactions. Such quarterly reports do not meet the FPA requirements. Additionally, the filing of the rates after the sale forces a buyer to use

Section 206 to challenge the rate -- thus shifting the burden of proof to the buyer and also limiting FERC's ability to order retroactive refunds. The Complaint relies principally on two U.S. Supreme Court cases: MCI Telecomm. v. AT&T Co., 512 U.S. 218 (1994) and Maislin Industries, U.S. Inc. v. Primary Steel, 497 U.S. 116 (1990). In these cases, the Supreme Court held that the FCC and the ICC could not waive statutory requirements that rates be filed prior to the implementation, even to promote competition. The Complaint requests enforcement and very sizeable refunds.¹

EXECUTIVE SUMMARY

The Complaint squarely poses the question whether FERC has violated the FPA by (1) allowing sellers with market-based rate authority to file rates that vaguely state "all sales shall be made at rates established by agreement between the seller and the purchaser"; (2) allowing market-based rates without a price cap (the Cal AG concedes such authority would exist were there a cap to prevent unjust and/or unreasonable prices); and (3) allowing insufficient quarterly transactional reports in which sellers with market-based rate authority summarize their short-term transactions rather than reporting individual transactions.

¹ The Notice of Complaint alleges that sellers of energy and ancillary services to the California Power Exchange ("PX"), the California Independent System Operator ("ISO"), and the California Energy Resources Scheduling Division of the California Department of Resources ("CERS") have violated Section 205(c) of the Federal Power Act (16 U.S.C. Section 824d(c)) and an express condition of their grants of market-based rate authority by failing to file their rates in the manner required by law. The Complaint alleges that Defendants' pro forma market-based rate schedules fail to provide FERC an adequate opportunity to determine in advance whether their rates are just and reasonable, and fail to provide the public with adequate notice of the rates to be charged. The Complaint further alleges that the Defendants' quarterly transaction reports, filed by up to four months after the completion of a market-based transaction, do not cure the statutory failure to file all rates prior to the time service commences. The Complaint further alleges that, even if quarterly, after-the-fact reporting of rates were found to comply with Section 205, sellers have failed to report transaction-specific information on their sales to the ISO, PX, and CERS, as required by FERC, negating any claim that their rates are on file. The Complaint seeks an order requiring sellers to: comply with the Section 205 rate filing requirements on a prospective basis; provide transaction-specific information to FERC on all sales to the ISO, PX, and CERS in calendar years 200-2001; and, to the extent any rates charged are found to exceed just and reasonable levels, refund the difference between the rates charged and a just and reasonable rate, plus interest.

As discussed below, (i) FERC has a good argument that it may enforce a regime of market-based rates if and only if FERC mitigates market power such that market-based rates are just and reasonable; (ii) the Cal AG is correct that as now submitted, quarterly transaction reports are so vague as to be meaningless; however, FERC has proposed to revise such reports to require more meaningful transaction-specific reporting data.

I. COMMENTS

A. FERC's Authority To Require Market-Based Rates

Section 205 of the FPA provides: “All rates and charges made, demanded, or received by any public utility for or in connection with the . . . sale of electric energy subject to the jurisdiction of the Commission and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.” 16 U.S.C. § 824d(a). The overriding purpose of prohibiting unjust and unreasonable rates and charges is “to protect consumers from exorbitant prices and unfair business practices.” Public Systems v. FERC, 606 F.2d 973, 979, n.27 (D.C. Cir. 1979). “[T]he prevailing price in the marketplace cannot be the final measure of ‘just and reasonable’ rates mandated by the Act.” FPC v. Texaco, Inc., 417 U.S. 380, 397 (1974).

Courts have stated that to be “just and reasonable” rates must fall within a “zone of reasonableness” where they are neither “less than compensatory” to producers nor “excessive” to consumers. When the inquiry is on whether the rate is reasonable to a producer, the underlying focus of concern is on the question of whether it is high enough to both maintain the producer’s credit and attract capital. To do this, it must, inter alia, yield to equity owners a return “ ‘commensurate with returns on investments in other enterprises having corresponding risks,’ ”

as well as cover the cost of debt and other expenses. . . . When the inquiry is whether a given rate is just and reasonable to the consumer, the underlying concern is whether it is low enough so that exploitation by the [regulated business] is prevented.” Farmers Union Central Exchange v. FERC, 734 F.2d 1486, 1502 (D.C. Cir. 1984) (citing City of Chicago v. FPC, 458 F.2d 731, 750-751 (1971)). “The ‘zone of reasonableness’ is delineated by striking a fair balance between the financial interests of the regulated company and ‘the relevant public interests, both existing and foreseeable.’” Id. (citing Permian Basin Area Rate Cases, 390 U.S. 747, 792 (1968)). In determining whether rates are fair and reasonable, courts have stated that “[T]he most useful and reliable starting point for rate regulation is an inquiry into costs.” Id.

While FERC has discretion in ratemaking methods, the burden is on the Commission to justify departures. Courts can require only that a “just and reasonable” rate be set, and cannot dictate ratemaking methods. FPC v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944); City of Chicago v. FPC, 458 F.2d 731, 749 (1971), cert. denied, 405 U.S. 1074 (1972) (a heavy burden is imposed on the Commission to justify departures from cost-based ratemaking). Rates must fall within a “zone of reasonableness” which is “bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates.”² As FERC has recognized in its orders, the Commission must justify departure from cost-based rulemaking:

UtilCo cites Farmers Union Central Exchange, Inc. v. FERC (Farmers Union) for the proposition that courts have given the Commission broad latitude to depart from traditional cost-of-service ratemaking, but that costs must always be a point of departure. However, UtilCo ignores the court’s statement in Farmers Union that “FERC is not

² Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1177 (D.C. Cir. 1987).

required to adhere rigidly to a cost-based determination of rates, much less to one that base[s] each [gas] producer's rates on his own costs." The court in fact acknowledged that non-cost factors may legitimate a departure from rigid cost-based ratemaking and that in some circumstances, the contrasting or changing characteristics of regulated industries may justify an agency's decision to take a new approach to the determination of just and reasonable rates. Each deviation, however, must be found not to be unreasonable and to be consistent with the Commission's statutory responsibility.³

"[W]hen there is a competitive market the FERC may rely upon market-based prices . . . to assure a 'just and reasonable' result." Elizabethtown Gas Co. v. FERC, 10 F.3d 866, 870-71 (D.C. Cir. 1993). "In a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable, and specifically to infer that the price is close to marginal cost, such that the seller makes only a normal return on its investment." Tejas Power Corp. v. FERC, 908 F.2d 998, 1004 (D.C. Cir. 1990) (emphasis added).

However, when the Commission authorizes market-based rates, it is under a continuing duty to ensure that the relevant market remains sufficiently competitive to prevent unjust and unreasonable prices. Process Gas Consumers v. FERC, 177 F.3d 995, 1002 (D.C. Cir. 1999) ("FERC must remain attuned to the status of the affected market vis-a-vis monopoly and competition."). Where markets are not sufficiently competitive to keep prices at reasonable levels, the Commission must exercise its ratemaking and refund powers to protect consumers.

FERC has the flexibility to allow market-based rates if it is assured that the result is just and reasonable rates, e.g., because market power does not exist or had been mitigated. In

³ See Public Service Company of Indiana, Inc., 51 FERC ¶ 61,367 (1990).

Farmers Union, 734 F.2d at 1502, the court rejected the Commission's reliance on a cap for oil transportation rates, because the cap was set at a level designed merely to prevent "egregious exploitation and gross abuse" rather than to ensure a just and reasonable rate. Although premised on an assumption that competition would keep prices in the "zone of reasonableness," the Commission made no findings that competition for oil transportation services was in fact sufficient to do so. The Commission did not look at market share or otherwise assess the number of competitors available to provide transportation service.

Similarly, in Tejas Power, the court rejected a gas inventory charge ("GIC") that deviated from the cost-based model then in place for natural gas pipeline regulation. The court held that the Commission had erred in accepting the rate as part of a larger settlement package, having "made no prior finding that [the pipeline] lacked significant market power vis-a-vis the [customers]." 908 F.2d at 1004.

FERC may implement a market-based rate regime only if it has made the appropriate analysis and findings. In Elizabethtown Gas Co. v. FERC, *supra*, and Louisiana Energy and Power Authority ("LEPA") v. FERC, 141 F.3d 364 (D.C. Cir. 1998), the courts have accepted the Commission's reliance on a market-based rate regime, *i.e.*, one in which rates are presumed to be just and reasonable due to market forces rather than a showing that they are equivalent to a cost-of-service rate or some other hypothesized benchmark. In Elizabethtown, the D.C. Circuit upheld a market-based rate for the sale of natural gas:

[W]e have indicated that when there is a competitive market the FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a "just and reasonable" result. See Tejas Power, 908 F.2d at 1004 ("in a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable,

and specifically to infer that the price is close to marginal cost, such that the seller makes only a normal return on its investment”). See also Farmers Union, 734 F.2d at 1510.

Here the Commission specifically found that “Transco’s markets are sufficiently competitive to preclude it from exercising significant market power in its merchant function”

10 F.3d at 870 (emphasis added). In LEPA, the court rejected arguments by a municipal utility claiming that the grant of market-based rate authority to its competitor would allow the competitor to engage in predatory pricing. In so doing, the court relied on the Commission’s prediction that its new open access transmission policies would prevent such an outcome and that competition and consumer welfare would be enhanced if the competitor were authorized to sell at market-based rates. “[S]hould the Commission’s sanguine predictions about market conduct prove incorrect, LEPA can file a new complaint for any abuses of market power that do occur.” 141 F.3d at 370.

FERC can meet the zone of reasonableness test if and only if the Commission is satisfied that the seller does not possess market power in any relevant market. Entergy Services Inc., 58 FERC ¶ 61,234 (1993) and cannot “significantly influence price in the market by withholding service and excluding competitors for a significant period of time.” Citizens Power & Light Co., 48 FERC ¶ 61,210 (1989). Only if market power does not exist will market forces drive prices towards marginal cost such that the seller makes only a normal return on its investment.⁴ Only if FERC finds that market power cannot be exercised can it find that the seller’s rates are just and reasonable.

⁴ As the Commission observed in a gas industry order:

In a competitive industry, market forces drive prices toward the producer’s marginal cost. Where price equals marginal cost, consumers are paying precisely the social cost incurred to produce the

While the Cal AG's assertion that market-based rates are unlawful absent a price cap is suspect⁵, a court is likely to conclude that market-based rates are only lawful if market power is mitigated. FERC finds itself on the horns of a dilemma. On several recent occasions FERC has recognized the existence of market power. FERC has proposed remedies such as (i) a supply margin assessment screen in considering renewal of market-based rate authority and (ii) a refund condition to apply to all market-based tariffs.⁶ However, FERC has hesitated to implement these reforms. FERC is vulnerable to litigation challenging market-based rate approvals so long as regulations effective to address market power remain unimplemented.

last unit of output. If at any time the price is too high, excessive returns will encourage other producers to enter the market, thereby increasing production, lowering prices, and eliminating excessive returns. Similarly, if demand increases, price will rise, encouraging additional production that was not economically viable at the lower price. This process will continue until supply and demand reach equilibrium and price reflects marginal cost. Prices established by competitive market forces are in this way driven toward marginal cost. Such prices send the proper signals to both producers and consumers, leading them to produce and consume the optimal amount of goods and services, and thus ensuring that society makes the most efficient use of its resources.

Ceiling Prices: Old Gas Pricing Structures, Order No. 45, FERC Stats. & Regs. ¶ 30,701 at 30,233 (1986), 51 Fed. Reg. 33,168 (June 18, 1986) (emphasis added).

⁵ The Complaint states:

To be clear, the Attorney General does not contend that market-based pricing per se violates the FPA. For example, FERC may institute a system where rates are determined by negotiation between buyers and sellers, so long as rates do not exceed a cap lawfully established by FERC. The cap be [sic] may be based on costs of production or any other measure that ensures rates are just and reasonable, so long as FERC has the opportunity to thoroughly review the cap before it goes into effect. A properly vetted cap provides sufficient notice to purchasers of the rates to be charged, with adequate assurance that rates charged at or below the cap are just and reasonable. In contrast, the current regime affords no opportunity for reasonableness review before rates go into effect, and is therefore fatally flawed.

Cal AG Complaint at 13-14.

⁶ See AEP Power Marketing, Inc., et al., ER96-2495 (Nov. 20, 2001); Investigation of Terms and Conditions of Public Utility Market-based Rate Authorizations, EL01-118 (Nov. 20, 2001).

B. FERC Must Act to Remedy Market Power in Bid-Based Markets

While ELCON takes no position on the context in which the Complaint is filed, the Cal AG's Complaint is relevant to the Commission's current endeavor to address anticompetitive behavior or the exercise of market power in other bid-based markets. The bottom-line is that FERC must do more to address market power if it is going to continue its generous policy for granting market-based rate authority.

ELCON members, however, do not favor a reliance on after-the-fact/*ex post* remedies to the exercise of market power by sellers with market-based rates. Market power mitigation in the context of market-based rate regulation must be *ex ante* – before the clearing price is set in bid-based markets.

The Commission's recently released Working Paper on Standardized Transmission Service and Wholesale Electric Market Design ("Working Paper") anticipates that the Standard Market Design ("SMD") will be modeled on bid-based day-ahead and real-time energy markets. Because bids are "cleared" using a uniform price auction (all suppliers get the highest bid that serves the last unit of load), the financial consequences of any exercise of market power gets greatly magnified by this auction format. The same holds true for other bid-based markets that the RTOs will be facilitating (e.g., ICAP and ancillary services).

ELCON members do not want FERC to rely on *ex post* fixes to the exercise of market power in existing and proposed bid-based markets. ELCON members fully support and congratulate FERC on its endorsement of demand response programs in the Working Paper.

However, if industrial consumers make a decision to shut down a manufacturing facility to sell their "load" as demand response, that decision will have been based on the prevailing market conditions. Any attempt to unscramble the egg through *ex post* remedies to the exercise of market power by suppliers subjects industrial consumers with load to sell to double jeopardy.

Market power mitigation must be *ex ante* in bid-based markets -- before the clearing price is set. In the day-ahead and real-time markets there is no choice but to highly automate this process within the RTO's software. The market price mitigation mechanism must force generators to bid their power into the market at their marginal costs. The success of the mechanism is driven solely by that outcome. Furthermore, FERC must aggressively address the potential exercise of market power by suppliers before granting such parties market-based rate authority. As such, ELCON fully supports FERC's proposed Supply Margin Assessment ("SMA") market power screen⁷, and urges the Commission to apply it to market-based rate suppliers both within and outside RTOs and ISOs. The Cal AG's Complaint highlights the importance of taking aggressive action to prevent the exercise of market power, even in bid-based markets run by ISOs and RTOs.⁸

C. Adequacy Of Quarterly Reporting

The Cal AG cites two Supreme Court cases, MCI Telecomm. Corp v. AT&T, 512 U.S. 218, 231 (1994), and Maislin Indus. v. Primary Steel, Inc., 497 U.S. 116, 132 (1990), for the proposition that utilities must file rates to satisfy statutory requirements. In MCI, the Court said

⁷ AEP Power Marketing, Inc., et al., ER96-2495 (Nov. 20, 2001).

⁸ ELCON notes that the Cal AG does not appear to be challenging long-term contracts negotiated by market-based rate suppliers. See Cal AG Complaint at 20, note 15. ELCON strongly believes in the sanctity of contracts and opposes after-the-fact regulatory interventions that disturb what was fairly negotiated.

that the FCC exceeded its authority in ordering detariffing because common carriers are required to file rates under 47 USC § 203(a); FCC has authority to “modify” not abrogate filing requirements under § 203(b)(2) of the Communications Act. While the Cal AG is correct that this case held that filing requirements were central to that statutory scheme and could not be eliminated by the FCC for the sake of deregulation, MCI is not controlling on FERC because it does not address FERC’s statutory obligations under the FPA. However, the cited cases do suggest the importance of filing requirements in analogous regulated industry regimes.

Assuming arguendo that FERC can fulfill its own FPA statutory mandate to determine that rates are just and reasonable by requiring after-the-fact quarterly reports, the reports currently required are inadequate. FERC has stated that quarterly reporting is necessary to assure that rates are on file “as required by FPA § 205(c) . . . to evaluate the reasonableness of the charges, and to provide for ongoing monitoring of [the seller’s] ability to exercise market power.” Enron, 65 FERC ¶ 61,305 (1993); Southern Co., 87 FERC ¶ 61,214 (1995); Reporting Requirements Applicable to Power Marketers, 72 FERC ¶ 61,082 (1995). However, at present transaction-specific data are not reported. FERC has itself conceded that the current quarterly reports make it difficult for the Commission to discharge its stationary duty and proposed revision to reporting requirements.” Revised Public Utility Filing Requirements, 96 FERC ¶ 61,135 (2001).

CONCLUSION

The Cal AG Complaint raises serious issues about FERC’s current implementation of market-based rates. The Complaint shines a spotlight on two problems: (i) unless market power is mitigated, market-based rates cannot be just and reasonable; and (ii)

FERC must immediately implement transaction-specific reporting requirements and utilize these reports to review instances of assertion of market power – the purpose for which such reports were intended.

NOTICES AND COMMUNICATIONS

Notices and communications should be addressed to

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Respectfully submitted,

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Dated: April 9, 2002

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Motion to Intervene and Comments of the Electricity Consumers Resource Council were today mailed to parties on the service list of this proceeding by U.S. mail, postage prepaid.

Dated at Washington, D.C., this 9th Day of April, 2002.

/s/ Kari Vander Stoep

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